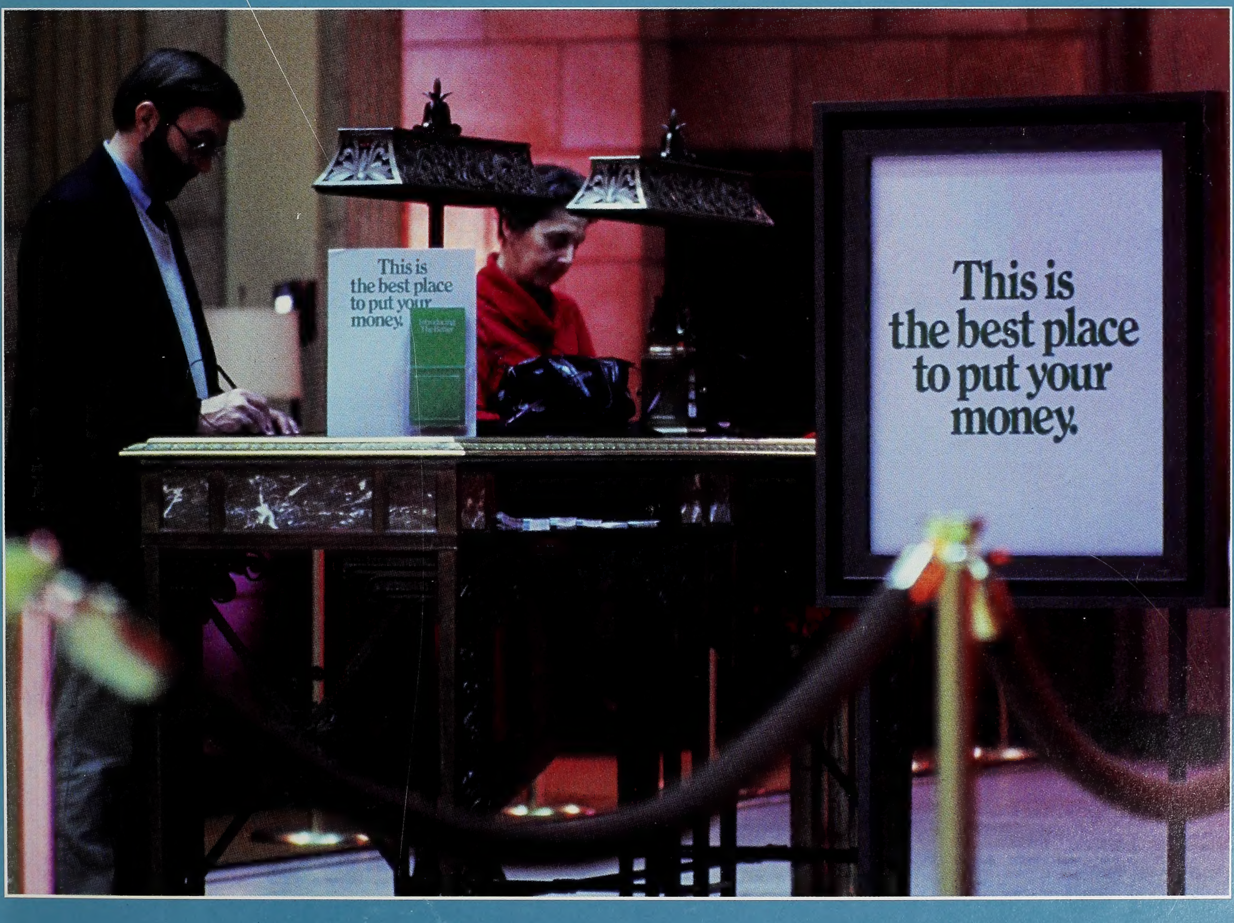
A BLUEPRINT FOR FAIRNESS

The Report of the Committee on Fair Dealing in Consumer Savings and Investments

January, 1989.



Acknowledgements

A number of people have contributed a great deal to the preparation of this report. The members of the Committee on Fair Dealing are foremost among them. I offer them my sincere thanks.

As a Committee, our gratitude also goes to the many individual consumers, consumer representatives, and representatives of the financial industry and government who contributed their time, perceptions, and expertise to the development of this report. They helped the Committee achieve a deeper understanding of the issues it studied than would otherwise have been possible.

The Committee would also like to thank Pamela McHugh for all her efforts in forwarding the work of the Committee and Terence Harding for his leadership in allowing the Committee to express its thoughts effectively.

J. Patrick Cashion, C.A.
Chairman
Ministerial Advisory Committee on Fair Dealing in Consumer Savings and Investments

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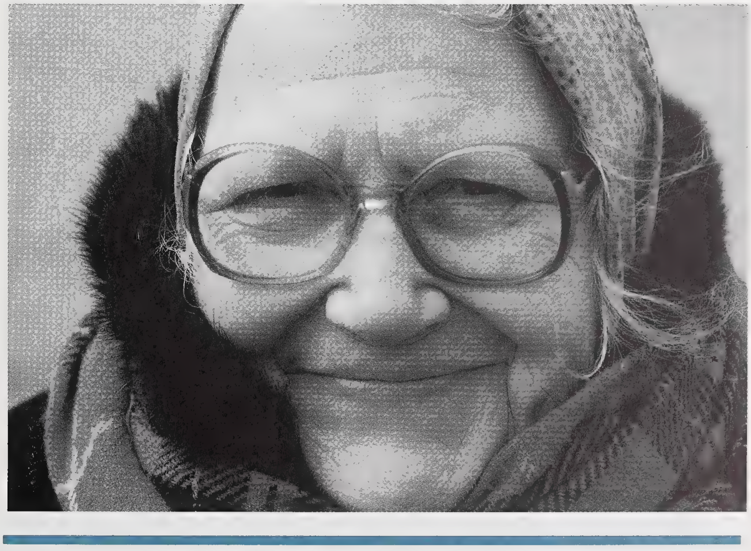
Introduction



1.1 The Current Challenge

Purpose of Report

This report presents the findings and recommendations of the *Ministerial Advisory Committee on Fair Dealing in Consumer Savings and Investments*. The composition and activities of the Committee are outlined on pages 12 through 26 of this report.

The subtitle of this report, *A Blueprint for Fairness*, reflects the desire of the Committee to produce recommendations which will contribute to the better regulation of the retail financial marketplace in Alberta and as a result, promote fairness now and in the future. The current state of the financial marketplace in Alberta is examined and steps which should be taken to maintain fairness in relation to consumer savings and investments are recommended.

The Committee has not determined whether actions on its recommendations fall under federal or provincial jurisdiction. Since the Committee is simply recommending action to maintain a fair financial marketplace, this report does not deal with the jurisdictional implications which may result from any of the Committee's recommendations. It does, however, recognize that such jurisdictional implications exist.

Focus of Report

This report focuses on safeguards for the individual consumer in the current Alberta retail financial market. The Committee recognizes this report will have an impact on business and professional investors, however, it believes that the needs of business and professional investors are best met by the inherent competitiveness of the marketplace. In essence, if a securities dealer or financial institution does not provide the best services available, it will not retain the business of its commercial clients. However, retail financial consumers often lack the expertise, resources, financial clout, and up-to-date information which would allow them to sufficiently protect themselves. As a result, there must be adequate safeguards for their savings and investments.

Risk in the Financial Marketplace

The Committee's examination of the marketplace and its recommendations based on that examination recognize that there are two types of risk in the consumer financial market: **acceptable risk and unacceptable risk.**

Acceptable Risk in the Financial Marketplace

Acceptable risk arises from the very nature of the financial marketplace and the types of products it has to offer. In essence, the marketplace operates on two basic premises:

- **the lower the risk inherent in the product, the lower the rate of return**
- **the higher the risk inherent in the product, the higher the rate of return.**

In this way, the marketplace *pays* the investor or depositor for the level of risk taken.

At the low-risk end of the spectrum is the Canada Deposit Insurance Corporation-insured savings account. This account may pay 9% interest and the consumer is at no risk of losing either capital or interest, up to the limits of CDIC coverage. In fact, this kind of account can be seen as a no-risk product.

At the high-risk end of spectrum is a speculative equity share in a high-risk business. This product might return 100% per annum or even more, depending on the success of the venture. However, it is possible for the consumer to lose the entire investment.

This variation in risks is normal and acceptable, as long as the consumer knows what risks are involved. The consumer can judge what level of risk is appropriate, and whether the rate of return justifies the risk involved.

Unacceptable Risk in the Financial Marketplace

Risk which is unacceptable is the risk that the consumer will lose money simply by conducting a transaction with a particular individual or institution. This risk has nothing to do with the *pricing* (rate of return) of a product in the market. This kind of risk is compounded in cases where the institution which is selling the investment or deposit product is not the institution which is actually providing the product. In this case, the consumer may be basing the decision to buy a product on the reputation and performance of the seller. If the consumer knew that the seller and the provider were different entities, the transaction might not take place.

The Committee believes that it is not right for the consumer to be put at risk because of factors having nothing to do with the merits of the product itself. Accordingly, the Committee takes the position that these risks should be eliminated where at all possible and minimized otherwise. Among the tools to be used in dealing with these unacceptable risks is high quality information, provided to a well-informed consumer.

Alberta As Financial Microcosm

Though the focus of this report is the financial marketplace in Alberta, Alberta is only a microcosm of what is happening in Canada and world-wide.

Regulatory Concerns - Canada-wide

During the last 20 years, the Canada Deposit Insurance Corporation (CDIC) has paid out approximately $4 billion in deposit claims. As a result, the CDIC is currently showing a deficit of more than $1 billion. The financial state of the CDIC is a barometer of problems within some types of Canadian financial institutions.

The need for reregulation of the Alberta financial marketplace discussed in this report mirrors a need for reregulation Canada-wide. Because of the constitutional division of powers among the provincial and federal governments, this need is currently being approached through cross-jurisdictional regulation. For example, securities commissions in Canada have adopted an update to the *National Policy on Mutual Funds*. This *Policy* provides guidelines on how mutual fund sponsors may advertise, handle client funds, and other important matters.

Regulatory Concerns - Canada-wide continued

Regulatory commissions from all provinces and territories worked for a year with the Investment Fund Institute of Canada to develop these guidelines. This effort was in response to sometimes misleading advertisements relating to fund growth, flexibility, and transferability, as well as concerns about the handling of client funds.

Another example of interprovincial movement toward better regulation is the information sharing agreement recently signed by the ministers responsible for financial institutions in the western provinces. This agreement allows the western provinces to exchange information regarding investigations, examinations, audits, and inspections of financial institutions regulated within their provinces. The Committee applauds this interprovincial cooperation and urges more provinces to consider this type of cooperation in other aspects of regulating the financial sector.

The recent collapse of Osler Inc. raises a number of questions about the self-regulation of stock brokers. It also calls into question the ability of the current regulatory system to police the industry. However, the Osler collapse has proved the ability of the stock exchanges and the Investment Dealers Association to protect individual investors through the National Contingency Fund (NCF). The NCF is designed to provide financial compensation to the public in the event of collapse of a member brokerage firm. In the case of Osler, the NCF was able to meet its obligations.

The last ten years have seen the failure of a number of financial institutions in Alberta. In 1985, liquidators were appointed for the Alberta-based, but federally regulated, Canadian Commercial Bank and Northland Bank. Dial Mortgage Corp. collapsed in 1981. Tower Mortgage Ltd. collapsed in 1983, Signature Finance Ltd. in 1984, and Principal Group in 1987. In addition, there were problems within some credit unions and trust companies.

In 1981, the Ontario-based Astra Trust Co., and its Re-Mor Investment Management Corp. collapsed. In 1983, the major trust and mortgage firms of Crown, Seaway, and Greymac were discovered to be insolvent after a series of massive real estate transactions.

It was only after the collapse of Crown, Seaway and Greymac that the maximum payout per claimant of the Canada Deposit Insurance Corporation (CDIC) was increased from $20,000 to $60,000.

Regulatory Concerns - U.S.

It appears that up to one-third of savings and loan institutions (thrifts) in the U.S. are insolvent and may have to be liquidated. This would require paying back their insured depositors in excess of $100 billion. This amount is far beyond the resources of the currently insolvent Federal Savings and Loan Insurance Corporation.

Regulatory Concerns - Britain

As early as 1970, problems were surfacing in Britain with the collapse of Investors Overseas Services. Ferrington Stead, a firm dealing in British Government Securities, collapsed in 1981. Barlow Clowes & Partners which offered *"high returns from managed investments in British Government Securities"* collapsed in June of 1988 leaving 18,000 investors without protection.

The changing nature of the British financial marketplace was the major force behind the 1984 Gower report on investor protection. The Gower report in turn lead to the *Financial Services Act* of 1986.

Increased investor protection was seen as necessary because of the advent of new technologies, the products they spawned, and the multitude of new firms which were being incorporated. The October, 1986 reregulation of the British financial market in turn increased the use of technology and resulted in an influx of foreign firms.

The British *Financial Services Act* is designed to protect investors from the collapse of securities firms and to prevent systematic overcharging and the exploitation of investor ignorance.

The Impact of Technology

The impact of technology on the Alberta financial marketplace cannot be viewed in isolation. The technology which has led to the creation of a multitude of new and complicated products and services has also spurred the globalization of the industry.

The Impact of Technology continued

Technology has only just begun to have an impact on the retail financial consumer. As the effects of technology become greater, the potential for customization of products to the demands of individual consumers is likely to explode. There will be virtually no limit to how sophisticated investment products can become. The consumer will soon be able to sit at home and move retirement funds from one investment to another using a home computer or telephone. A phone company in central Canada is in the process of beginning to market just such a service.

The arrival, through technology and reregulation, of world-wide financial markets opens new avenues to the small investor. As a result, new factors are introduced into the decision-making process and the complexity of investment decisions is compounded.

The Change in Marketing Strategies

The narrow bands of interest and endeavour which characterized the activities of banks, trust companies, insurance companies, and securities dealers are disappearing. The result is financial conglomerates with a previously unimagined range of products, and a host of services and marketing strategies which are exerting a tremendous financial influence on the international market.

Products originally designed for the commercial marketplace are now being modified and offered to retail investors. Without products such as options and index futures, the customization of retail investment and deposit products would not be possible.

Banks, trust companies, and insurance companies have the marketing expertise and financial clout to aggressively compete for individual market segments. Open marketing warfare is the result. An intense battle for the consumer savings and investment dollar may further complicate the market and make informed consumer decisions more difficult.

Changes to federal and provincial tax policies affect marketing strategies by making certain financial plans, such as Registered Retirement Savings Plans, marketable on the basis of their tax deferral qualities.

The Sale of Financial Advice

The complexity of the financial marketplace appears to have driven many consumers to seek financial advice. Many consumers look to experts to help them navigate the shoals of savings and investment decisions in order to achieve financial security. As a result, the title *salesperson* is rapidly disappearing. It is most commonly being replaced with the title *financial planner* and such titles as *financial advisor, investment advisor,* and *financial consultant.*

The financial planner plays an important role in today's complex marketplace. However, in Alberta, financial planners operate virtually without regulation. Consumers have no guarantee that they are receiving sound, or even ethical, advice concerning their financial futures. This set of circumstances is not restricted to Alberta. The same situation exists throughout Canada and in the United States as well. The North American Securities Administrators Association estimates that in the last two years approximately 22,000 investors lost $400 million in financial planning frauds in the United States. The Committee believes that everything possible must be done to prevent this kind of situation in Alberta.

The Consumer-Government-Industry Partnership

Maintaining a fair financial marketplace in Alberta requires an interactive, dynamic partnership among consumers, the financial industry, and government. Given the complex nature of today's financial marketplace, none of these groups alone has either the ability or resources to create and maintain the safeguards which are necessary.

Consumers are their own best protection in the marketplace. They best know how to maximize their return and minimize their risk of loss based on their own financial objectives. However, the creation of a multitude of new and increasingly complex products, the globalization of financial services, and the advent of consumer-accessible advanced technology make determining risk and return very difficult for the consumer to achieve unaided.

Consumers have common sense, but they require common sense information in order to exercise it. The financial industry should provide that information. In addition to self-instruction, the consumer must rely on the assumption of effective government regulation and the expectation of ethical industry behaviour.

The Consumer-Government-Industry Partnership continued

The government alone cannot and should not regulate all aspects of the financial marketplace. To do so would require marshalling a level of human and financial resources which would place an onerous burden on the taxpayers of Alberta. In addition, massive amounts of government regulation would seriously limit the development of the financial marketplace itself. Consumer choice would be unnecessarily restricted and many of the benefits which accrue to individual depositors and investors would disappear. In the end, consumers would pay too high a price for this overprotection.

The financial industry recognizes it has a responsibility for consumer protection. However, to place the burden of responsibility solely on the industry would be both unreasonable and unrealistic. In order to meet the needs and expectations of consumers, the financial industry requires advice from consumers and guidelines from government. There is a tendency for any group to see reality only from its own perspective. It would be unrealistic to expect the financial industry to overcome this limitation.

The Committee believes there should be a minimum of government interference in the efficient operation of the marketplace. Intrusion on the part of government should only occur when it is needed to safeguard the consumer.

The Committee recognizes that there are areas in its recommendations where cooperation with other jurisdictions will be required. It did not consider a full examination of cross-jurisdictional issues to be a part of its mandate. The Committee recognizes that the Minister will take these cross-jurisdictional issues into account in considering its recommendations.

Maintaining a Fair Financial Marketplace

Alberta wants and needs a stable but expanding financial marketplace. This marketplace must treat consumers fairly. It is clear that fair treatment is in the best interests of all concerned. As a result, though one party may have more responsibility in a particular area, all parties must share responsibility for all aspects of the retail financial marketplace.

Maintaining a Fair Financial Marketplace continued

It is only through a dynamic, interactive partnership among industry, consumers, and government that the needs of consumers and the growth of the marketplace can be assured. This report presents a blueprint for how this partnership in fairness can be achieved.

Recommendations of the Committee

The Committee has made recommendations in the following areas:

- **consumer learning resources**
- **consumer access to information**
- **consumer safeguards**
- **regulation of the financial marketplace**
- **financial industry's role in the marketplace**
- **government's role in the marketplace.**

Summaries of these recommendations along with their locations in the report are provided in this section.

Recommendation Summary - Consumer Learning Resources

The Committee believes that consumers have an obligation to keep themselves informed about financial products and services. However, the Committee also recognizes that both government and the financial industry have an obligation to enable consumers to achieve effective self-education. In this regard, this report contains the following recommendations:

- **creating a joint industry/government educational task force [page 45]**
- **including financial instruction in schools [page 46]**
- **encouraging financial instruction in the workplace [page 47]**
- **using advertising to educate consumers [page 48]**
- **ensuring instruction occurs at the time of purchase [page 49].**

Recommendation Summary - Consumer Access to Information

The Committee believes that informed financial consumerism can only be achieved if consumers have access to all relevant information regarding financial products and services. The Committee also believes that this information must be presented in a manner which maximizes its usefulness. To achieve this goal the Committee has recommended the creating of a *Consumer Savings and Investment Information Act* [page 54]. The Committee is recommending that the proposed *Act* embody these principles:

- **plain language [page 59]**
- **product labelling [page 61]**
- **standardized terminology [page 62]**
- **standardized disclosure format [page 63]**
- **timely financial information [page 64]**
- **up-to-date information [page 65]**
- **disclosure of qualifications of sales personnel [page 67]**
- **disclosure of compensation of sales personnel [page 68]**
- **disclosure of deposit insurance information [page 70]**
- **access to accounting and audit information [page 73].**

Recommendation Summary - Consumer Safeguards

Though the Committee believes consumers have the major role to play in their self-protection, it also believes that the complexity of the current financial marketplace has created a number of areas where consumers can only be protected through the existence of adequate safeguards. These safeguards include:

- **regulating financial planners [page 75]**
- **cooling-off periods [page 79]**
- **prohibitions against conflicts of interest & self-dealing [page 81]**
- **prohibitions against insider trading [page 82]**
- **protecting confidentiality of consumer information [page 83]**
- **regular review of industry sponsored insurance funds [page 84]**
- **widening the financial industry's safety net [page 85]**
- **limitations on networking and cross-selling [page 86]**
- **changes to term note exemptions [page 88]**
- **regulation of dealers in commodities futures [page 89]**
- **restrictions on mortgage banking [page 90]**
- **restrictions on investment contracts [page 91]**
- **restrictions on the handling of investment funds [page 92].**

Recommendation Summary - Regulatory Model

The Committee believes that the current financial marketplace requires a change in how it is regulated. The regulatory model must reflect the current activities of all members of the financial industry. To achieve this goal the Committee is recommending:

- **a new regulatory framework [page 98]**
- **establishing and monitoring standards of practice [page 103]**
- **a regulatory alert system [page 105]**
- **a Delegated Regulatory Organization alert system [page 105]**
- **removal of exemptions under the Securities Act [page 106].**

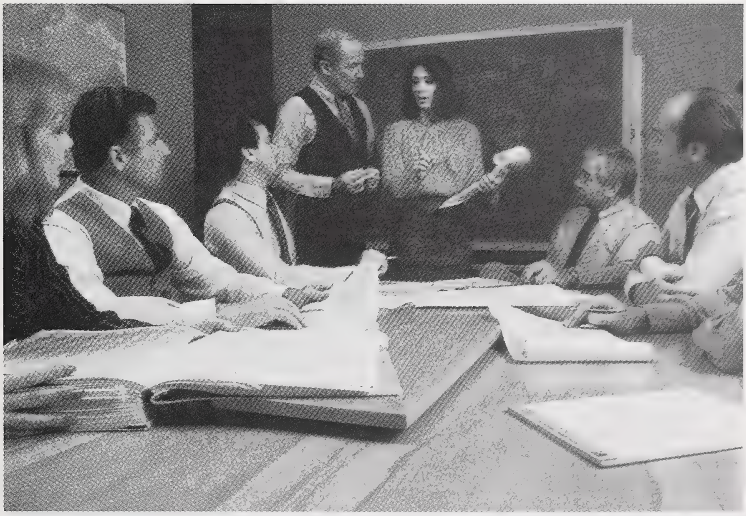
Recommendation Summary - Ongoing Activities

The recommendations contained in this report will go a long way in ensuring a fair financial marketplace. However, the rapidity of change in the marketplace demands both government and industry play an ongoing role in responding to these changes. To this end, the Committee is recommending:

- **establishing an educational task force [pages 45 and 109]**
- **developing methods for consumer education [page 114]**
- **ongoing communication and cooperation [page 115].**

2.

The Committee on Fair Dealing



2.

2.1 Overview

Members of the Committee

The Committee on Fair Dealing in Consumer Savings and Investments was composed of representatives of consumers, industry, and government. Its members were already aware of, and concerned about, many issues relating to consumer safeguards in the financial marketplace. A complete list of Committee members is provided in Appendix 1 of this report.

Mandate of the Committee

Elaine McCoy, Minister of Consumer and Corporate Affairs, became concerned that rapidly changing circumstances in the financial marketplace were creating unnecessary risks for consumers. Because of her concerns, the minister constituted *The Committee on Fair Dealing in Consumer Savings and Investments.* The minister charged the Committee with examining the range of consumer savings and investment products and services available in the current financial marketplace.

The Committee was asked to determine if adequate consumer safeguards were in place. It was to do this by looking at the quality of products and services available as well as the quality and practices of the industry personnel who delivered them. These activities were to require consultation with both consumers and representatives of the financial industry.

If as a result of its examination, the Committee found that safeguards for the individual consumer were inadequate, it was to make recommendations to the minister as to how adequate safeguards could be achieved.

Products and Services Examined by the Committee

Financial products with savings or investment features were examined. Products combining one or both of these financial features with other features were considered within the mandate. For example, whole life insurance policies have a savings or investment component and, as a result, fall within the mandate. However, term life insurance does not. Other products within the mandate include mutual funds, Guaranteed Investment Certificates, savings accounts, and plans such as Registered Retirement Savings Plans and Registered Retirement Income Funds.

" In order to invest, you have to have some money to spare that you can afford to lose."

Pre-retirement saver - Wetaskiwin

Results of the Committee's Examination

Many consumers assume that the financial marketplace is no different than the general consumer marketplace. However, questioning of consumers and industry sources revealed to the Committee that the retail financial marketplace cannot be governed solely by the rules and regulations which apply to the general consumer marketplace. The main characteristics of the financial marketplace are **risk** and **volatility**. As a result, a specific set of safeguards must be in place to protect the consumer.

2.2 Methodology

Identification of Issues

The initial discussions among the members of the Committee helped determine the general areas which required examination:

- **security of investments**
- **quality of sales and advisory personnel**
- **quality of investments**
- **compensation of sales personnel**
- **liquidity of investments**
- **disclosure of pertinent information**
- **suitability of investments.**

Use of Consumer Focus Groups

Regardless of how the industry views the state of the marketplace, the consumer of financial goods and services must be the final arbiter. With this in mind, the Committee initiated focus group testing related to the financial marketplace. Consumers were asked for their experience, concerns, and comments in the following areas:

1. **The difference between saving and investing.**
2. **How savings and investment decisions are made.**
3. **Who consumers use for financial advice.**
4. **The accessibility of financial information.**
5. **The readability of financial information.**
6. **The quality of financial products.**
7. **The comparability of financial products.**
8. **The competence of sales personnel in the industry.**
9. **The Canada Deposit Insurance Corporation.**
10. **The role of government in regulating the industry.**
11. **The role of industry in its own regulation.**

Quotes from these consumers are used throughout this report. While the Committee believes that these comments are indicative of general consumer attitudes, it does not ascribe a statistical validity to the testing results.

Other Sources of Information

Committee members interviewed a cross-section of industry and consumer representatives. These representatives were questioned about the areas of concern developed by the Committee as well as other relevant topics.

To the financial industry:

"Be honest and above board. If the consumer asks which product is best, give all the details, but let the consumer make the final decision."

Pre-retirement saver - Hanna

Committee members met with representatives of the **Consumers' Association of Canada (CAC)**.

The Committee also met with a representatives of the following organizations:

Alberta Mortgage Brokers Association
Alberta Treasury Branches
Canadian Association of Financial Planners
Canadian Bankers' Association
Canadian Bond Rating Service
Canadian Direct Marketing Association
Canadian Life & Health Insurance Information Council
Credit Union Federation of Alberta
Credit Union Stabilization Corporation
Dominion Bond Rating Service
Institute of Chartered Accountants of Alberta
Investment Dealers Association of Canada
Investment Funds Institute of Canada
Trust Companies Association of Canada

Investigation of Issues With Industry and CAC

The Committee approached representatives of the financial industry with a specific set of concerns related to the general areas it agreed required examination. Interviews covered, but were not restricted to, the questions outlined in this section of the report. Appropriate variations of these questions were posed to the **Consumers' Association of Canada**.

Questions Concerning Security of Investments

Investors cannot rely solely on the assurances of the financial institution to determine if their investments are secure. The degree to which an investment is secure depends on a complex relationship between underlying assets and the investor's deposit. In some instances the relationship is easy to explain, in others it is quite difficult to do so. Therefore, the Committee asked the following questions relating to security of investment.

1. **What financial products do you currently offer?**
2. **What is the underlying security for each product?**
3. **Do you think some retail financial products should not be sold because the investor is incapable of determining either the underlying security or the quality of the product?**
4. **What insurance coverage exists for the capital and the earnings of each type of product you sell?**
5. **What are the conditions under which insurance would be paid?**

Questions Concerning Quality of Investments

All investors are concerned about the security of their investments. Because not all investments are insured or equally secured, the Committee wanted to investigate objective ratings or indicators of investment quality. Therefore, the Committee asked the following questions relating to quality of investment.

1. **What independent ratings services exist for the particular financial products you offer?**
2. **Is it possible and practical to establish ratings systems where they do not currently exist?**
3. **What alternatives to a rating service are available which would clearly indicate variations of security and disclosure of underlying security?**

Questions Concerning Liquidity of Investments

Many investors are concerned about the liquidity of their investments. The Committee wanted to determine the liquidity of various investment products and the effect of liquidity on the consumer. As a result, the Committee asked the following questions relating to liquidity of investment.

> To the financial industry:
>
> *"Have information available to customers which can be easily understood by the general public so we don't have to go to financial experts to understand it."*
>
> Investor - Hanna

1. **Which of your products can be liquidated at any time and what is the cost of doing so?**
2. **Do you notify the investor of any actual or perceived increase in the risk of the investment after the investment is made and before it matures?**
3. **Do you notify the investor of the right to liquidate an investment before it is automatically renewed?**
4. **What products do you sell which allow the consumer the right to cancel or withdraw from the investment and does a cooling-off period exist?**
5. **Do you think such rights of withdrawal could be created and under what circumstances and conditions could they be used?**
6. **If rights of withdrawal were created, what conditions and time periods would be practical?**

Questions Concerning Quality of Personnel

A large number of people are involved with the public in financial transactions of one kind or another. Some are highly trained and able to give expert advice, others have little or no expertise. Since the public depends on the personnel of financial institutions in making savings and investment decisions, the Committee asked the following questions about the qualifications of personnel.

1. **What qualifications do your sales personnel have?**
2. **What qualifications do other personnel dealing with the public have?**
3. **What training do you give to your personnel who deal with the public?**
4. **What is the public told about the qualifications of your personnel?**

Questions Concerning Compensation of Sales Personnel

The nature and extent of compensation of sales personnel is important information for the consumer when the basis of such compensation would affect the reasonable consumer's decision to complete a financial transaction. For example, consumers should know when a salesperson stands to gain more by selling one product rather than another. As a result, the Committee asked the following questions relating to the compensation of personnel.

1. **For which products or services are your salespeople compensated, directly or indirectly?**
2. **How is the compensation for each type of product or service calculated?**
3. **Is the consumer made aware of how compensation is calculated for each type of product or service?**
4. **When compensation varies for different products, is the investor made aware of the variations when being presented with the advantages and disadvantages of investing in each?**

Questions Concerning Disclosure and Consumer Information

Practical limitations exist as to how much information can reasonably be provided to investors **before** an investment is made and at the time **when funds are actually committed.** Most importantly, there are the limitations on how much data investors will have the time and expertise to compare when making an investment commitment. At the same time, however, there appears to be an increasing concern among investors related to the quality and quantity of information they receive about the investments they make. Therefore, the Committee asked the following questions relating to disclosure and consumer information.

To the financial industry:

"Write information in language the average person can understand; and make it people friendly. Have people who will explain things clearly to the consumer."

Retirement saver - Wetaskiwin

1. **How much information is provided to the investor about each investment product prior to making a commitment to invest?**
2. **How much written information does the investor receive explaining the terms and conditions of the transaction after it has taken place?**
3. **What written information is provided outlining whether or not the investment is insured, to what extent, by whom, and under what conditions?**
4. **Is there any standardized industry terminology for each product?**
5. **Is the use of any standardized terminology obligatory?**
6. **What steps are being taken to promote the use of plain language in investment documentation?**
7. **What industry-wide rules exist concerning simplicity, clarity, and accuracy in advertising?**
8. **What would your reaction be to government regulation of advertising?**
9. **What has your industry done to promote or enforce the use of consistent terminology?**
10. **What steps has your industry taken with respect to consumer education?**

Questions Concerning Suitability of Investments

The Committee was aware that securities dealers have a responsibility to consider whether a particular investment is suitable for a client. As a result, the Committee asked the following questions relating to suitability of investments.

1. **Does the industry have a code of conduct for its members governing relationships with investors?**
2. **How is the suitability of an investment for a particular investor judged?**
3. **Are the rules respecting investment suitability appropriate for the industry?**

Questions Concerning Networking

The Committee wanted to determine the nature of 'networking' arrangements which have been put in place or which are being proposed. Therefore, the Committee asked the following question relating to networking.

As the trend to common ownership among various types of financial institutions advances, what steps do you propose to take to ensure that consumers are aware of all the matters we have discussed where the products/services of two affiliated institutions are involved?

Results of Committee's Activities

This report contains the findings of the Committee based on the methodology outlined in this section as well as the Committee's recommendations in relation to those findings.

2.3 Issues

Overview

The Committee found a financial marketplace in which consumers are exposed to many unnecessary risks. Consumer focus groups indicated that rapid change, limited access to information, some underqualified service personnel, and marketing pressure are among the factors contributing to this risk. Although much of the marketplace is working well, the Committee is of the opinion that consumers' concerns about the access to information regarding the quality of the products and services offered, and the reliability of the market's structure, seem justified.

The Financial Supermarket Is an Emerging Reality

The Committee started its investigation aware that changes had taken place in the structure and complexity of the financial marketplace. However, the Committee was surprised by the degree of change it found. The financial marketplace today is far different from that of the past and even more profound changes are likely in the future.

To Consumer & Corporate Affairs:

"Make available literature and listings of all reputable companies."

Consumer - Manning

The financial marketplace is truly becoming a supermarket. A wide variety of products are sold to people in every walk of life. Consumers no longer have to seek out savings and investment opportunities. Posters soliciting sales can be seen on many city street corners and in the media. Registered Retirement Savings Plans, Registered Retirement Income Funds, and other financial plans and products are touted in the mail. Promotions are aimed at virtually every age and economic level.

A large number of products and services are being offered to a wider range of the consuming public. As a result, it can no longer be assumed that only those with specialized knowledge and risk capital will be taking part in complex financial transactions.

A Bewildering Array of Products Exists

Development of product lines has resulted in a bewildering array of new products and types of products. The Committee found a marketplace in which new products and services are developed almost daily. Some of these products are being offered by new sources or sources previously operating in different areas. The industry is developing new products to both meet and create specific consumer demand. Distinguishing between the hundreds of choices at hand is confusing for all but a very few consumers.

At one time, saving institutions offered a simple choice between a chequing and a savings account, with fixed conditions and terms for each. As technology became available, daily-interest accounts became common. As further technological advances come on stream and competition for the consumer's investment dollar increases, extremely sophisticated products are appearing. The complex characteristics of one type of account are shown below:

THE NOT-SO-SIMPLE SAVINGS ACCOUNT

- **funds on deposit with a major international bank**
- **principal is insured by Canada Deposit Insurance Corporation (CDIC)**
- **rate of return is set as the rate of change in an index of stocks on the New York Stock Exchange (NYSE)**
- **depositor can switch from the NYSE index to a fixed rate of return at any time**

An account like this requires not just one decision but ongoing management by a well-informed consumer who is aware of the pitfalls of particular decisions. The nature of this type of account changes the consumer from a saver into part saver, part speculator.

The Complexity of Choices Has Increased

So many financial products and services are being offered to the general public that many consumers may not be able to fully understand the choices they have. Some products are being offered which resemble traditional ones, but which are actually significantly different. Items called term deposits are offered by many institutions. However, the security, insurance, and terms of these instruments vary widely. They are not all the same product in relation to what they do for the consumer. Nor are they all subject to the same regulations and restrictions. The same can be said of other products such as Guaranteed Investment Certificates (GICs). While the financial institution issuing the GIC *guarantees* a specified rate of interest for a stated period of time, some GICs are neither government-backed nor insured by the Canada Deposit Insurance Corporation, while others are.

To the financial industry:

"Give the consumer a straight answer to the questions asked, without prejudice and in simple language."

Consumer - Edmonton

Many products now offered to the average consumer would a short time ago only have been considered by a professional investor. There is every reason to expect that the range of products offered to the public will continue to expand at a rapid pace. As a result, the task of selecting the appropriate product will become more difficult for the consumer.

The Lack of Usable Information

Information available to the public when *shopping* for financial products and services is often incomplete or confusing. Data on similar offerings from different sources may be given in different forms. This makes comparison virtually impossible. Jargon and terminology which are used inconsistently add to the problem. Consumers who cannot get the information they need to evaluate and compare financial products and services are not able to make appropriate, effective choices.

The Intensity of Marketing Has Increased

Competition among institutions and sales personnel for the savings and investment dollar is fierce. To lure clients away from competitors, new products are designed and advertising campaigns mounted. Since the marketplace has already expanded to include the general public, the struggle for market share is intense.

The Intensity of Marketing Has Increased continued

Competition leads to genuine benefits for the consumer, but it also leads sales personnel to demand more and different products to sell. Consumers may be overwhelmed by the types of new products, the rate of growth in product lines, and the pressure applied by aggressive marketing. At no time is this more apparent than during the Registered Retirement Savings Plan season.

Many retirement investors in particular are not experienced in dealing with the amounts of money they have to invest. At the same time, these relatively large sums makes them attractive targets for aggressive sellers. In general, the public is at a disadvantage because consumer education has lagged behind sales promotion and product development.

Confidence in the Marketplace Has Been Eroded

Recent problems in the financial marketplace have contributed to the erosion of public confidence in the financial system. The failure of several financial institutions and the serious difficulties of others has made the public aware that not all such institutions are safe holders of their funds.

Consumers who give their savings to a company which later collapses may feel cheated by the system as a whole. Lack of confidence can, in time, have serious consequences for an industry which depends on consumers' savings and investments to function and grow.

Traditional Vertical Regulation of the Financial Marketplace

Page 21 of this report contains a discussion of the *financial supermarket*. The supermarket analogy is particularly appropriate to the discussion of the regulation of the financial marketplace. In the past, the concept of the financial supermarket did not exist. Instead, the market was divided up among particular institutions. Each institution was limited to selling various products and services. This situation is analogous to the days before the advent of the *superstore*. The foodstuffs market was divided up among butchers, bakers, grocers, and so on. Traditionally, the financial supermarket was divided up among banks, trust companies, securities dealers, and the insurance industry. Because each institution sold unique products and services, each was governed by its own set of government regulations.

To Consumer & Corporate Affairs:

"I don't like government involvement, but you need to have government do something, and if so, it should be a watchdog."

Retirement Saver - Manning

Vertical Regulation in a Horizontal Marketplace

The traditional separation of financial institutions was based on the exclusivity of their products and services. However, in the past few years financial institutions have begun to cross the dividing lines which previously separated them. They are now actively competing with each other for the sale of substantially the same products and services. The orientation of the marketplace is now *horizontal* rather than *vertical*.

This institutional crossover into other marketing areas has sharply reduced the effectiveness of the traditional regulatory model. It has resulted in a situation where the same product can be sold under a different set of rules, depending upon what kind of financial institution the salesperson works for. For example, securities firms now offer cash management accounts which act very much like traditional bank accounts. However, they are not subject to the controls of the *Bank Act*. In addition, substantially similar products may be sold subject to very different rules of disclosure, based solely on whether the seller is a bank, trust company, securities dealer, or insurance company.

As a result of the emergence of the *horizontal* marketplace, the consumer cannot rely entirely on traditional *vertical* regulation for appropriate safeguards. This is because vertical regulatory rules sometimes do not work effectively when a particular type of product is sold by an individual or an institution which formerly was not allowed to sell it. Rules which suit that product are in place for some sellers but not for others.

New standards which cross institutional lines must be developed. These standards will be related to specific products rather than to the institutional structure, although they will not replace the institutional structure. Safeguards will only be adequate when they are updated to reflect this crossing of old boundaries.

The Quality of Sales Personnel Is Inconsistent

Today, more people are involved in selling a broader range of products than at any time in the past. The training and expertise of the personnel advising or selling to the public varies considerably. Some financial instruments can be purchased through clerks who know little more than how to fill out the necessary forms. Other products are suggested by advisers who stand to gain financially from the transaction. Consumers may be left guessing what the service personnel's knowledge and motivation is.

The Quality of Sales Personnel Is Inconsistent continued

In a confusing and rapidly changing environment, the public relies on service personnel to promote and protect their interests. If personnel are poorly trained or improperly supervised and regulated, consumers take an unnecessary risk when placing their trust in them. The structure and complexity of today's financial marketplace leaves a large proportion of the investing public at a disadvantage when making deposits and investments unless they can rely on knowledgeable, ethical advisors.

3.

The Current Financial Marketplace

3.

3.1 Overview

The Increase in Complexity

Consumers have always needed to be cautious and informed when deciding what to do with their savings and investments. They have also had a direct responsibility for determining the desirability of their savings and investment decisions. However, in the past, the products and services available in the retail financial marketplace were limited - both in number and in complexity. Most consumers could, with a little effort, reasonably understand the majority of financial products available to them. In addition, most products available to the retail purchaser were *'consumer friendly'*. Their structure, function, use, and desirability were relatively easy to determine.

> To the financial industry:
>
> ***"Have flyers and leaflets so the customer can take them home and read them, then come back for clarification."***
>
> Investor - Hanna

Today's retail savings and investment marketplace has grown increasingly complex. Even at its current level of development, making choices in the financial marketplace demands an amount of information and a degree of expertise which many consumers may not possess. As technology makes innovation both possible and profitable, what now seems like a complex marketplace with a multitude of choices may be looked back on as a simpler and less sophisticated environment.

The Challenge to Consumers

As the Committee's focus group testing indicated, the change in the financial marketplace has not escaped the notice of most consumers. A visit to any bank or trust company makes this change quite apparent. The number of products and services available is staggering. Financial products and services are advertised on television and radio, in the daily paper, and through the use of direct mail. The same institutions which offer hundreds of products and services acknowledge how difficult the exercise of informed financial consumerism has become. As a result, a service which these institutions commonly offer is guidance on how best to purchase these very products and services.

The Multitude of Products

Even consumers who only want to open a savings account soon learn that this is not the simple process it once was. They must decide if they are willing to pay a price for a range of services. They must decide if opening a daily-interest account is to their advantage. Depending on their long-term goals, they may have to decide if it is indeed a savings account that they want or need.

It is difficult and time consuming to determine the difference between the *SuperRate Savings Account,* the *T-bill Savings Account, Investment Chequing*, the *Progress Account,* the *Gain Plan,* the *Moneybuilder,* and *Investment Savings.*

Some of these types of accounts pay no interest on deposits below \$5,000. Some only pay a top rate on amounts over \$25,000. Others have a tiered interest rate structure. One type of tiered account pays one rate of interest on amounts up to \$3,000. It pays another rate of interest on amounts over \$3,000 and a different rate on amounts over \$10,000. However, if the account balance is \$11,000, the highest rate is only paid on the last \$1,000. The second rate of interest is paid on the next \$7,000 and the lowest rate of interest is paid on the first \$3,000.

Without appropriate information which is clear and readily available, the fact that interest paid on this type of account is sometimes calculated using the minimum-balance method may escape the notice of many consumers. They could assume that they benefit from high interest rates and liquidity at the same time, when in fact, interest is being paid at a much lower rate because their balance has fallen below a certain level.

The Tip of the Product and Service Iceberg

As complex as the situation is concerning bank accounts, changes in the financial marketplace go far beyond a choice of savings accounts. Consumers who venture into the financial marketplace soon find that these choices represent only the tip of the iceberg. The more consumers learn about the current financial marketplace, the more difficult they find it is to make an informed decision. The difficulty in picking a savings account pales in comparison to the difficulty and potential downside of making incorrect choices in investments. This is particularly true for the retirement investor.

The Difficulty of Informed Decisions

Innovative products and services have flooded the marketplace, giving consumers a sometimes bewildering array of choices. New features and options have been developed and combined into financial products which are not familiar. The Committee has concluded that this proliferation of new products and services does not necessarily heighten the risk to the financial consumer. However, this is only true if the consumer receives appropriate, understandable information about these products and services which can be used to make a responsible choice.

Because consumers now have the option of choosing more complex financial products, there is a need for consumer access to detailed information. For example, consumers with $10,000 have ready access to T-Bill accounts which pay interest at the money market rate based on the Bank of Canada 91-day Treasury Bill auction. However, in spite of its name, this account is not a T-Bill account. It is an account which pays interest based on the T-Bill rate.

This type of account is also available with chequing privileges. However, there are a number of factors and restrictions which will determine how well this type of account functions for the consumer. Determining if this type of account best suits one's needs is far more complex than the traditional choice between a savings account and a chequing account.

The *Collapse of the Four Pillars*

The traditional *four pillars* of the financial marketplace were banks, trust companies, insurance companies, and securities dealers. Each of these institutions was limited to the sale of particular products and services and each type of institution was governed by different regulations. Because each institution had a narrow band of interest and activities this vertical regulation worked quite well.

> ***"I save because I like to have my cake and eat it too. I'm not a gambler."***
>
> **Pre-retirement saver - Wetaskiwin**

This situation is changing. Much has been made of the *collapse of the four pillars,* but the term *collapse* is misleading. In fact, the *four pillars* are being systematically dismantled. Given the modern, global, telecommunications-based market, the financial industry felt that the previous vertical market structure and regulation were impractical and unrealistic. Each type of financial institution had developed innovative products within their boundaries. This in turn led to a desire to market these products outside their traditional boundaries.

The *Collapse of the Four Pillars* continued

Fueled by consumer interest, this *collapse of the four pillars* is resulting in a reregulation of the operation of the financial marketplace. For example, while restrictions on the traditional business powers of financial institutions have been lessened by various governments, the accountability of officers, directors, and audit committees has been increased. However, there is virtually no legislative emphasis on access to information about financial products and services to consumers. The Committee feels the issue of insuring proper flow of information must be addressed.

Determining Who Sells What

Prior to changes in regulation of the financial marketplace, it was fairly easy for consumers to determine which types of institutions sold which types of products. It was also easier to determine the function and individual desirability of particular products.

To a considerable extent, banks, trust companies, insurance companies, and securities dealers are no longer distinctly different entities with separate functions. It is difficult for many consumers to determine who specializes in what products and services. It is also increasingly difficult to tell if there is any difference at all between institutions. Though it is difficult to tell the difference now, it may be even more difficult in the future.

The Sellers and Their Products Have Changed

Trust companies were once restricted to a limited range of products and services. A survey of print advertisements for trust companies in the late 1950's shows a concentration on:

- **estate planning**
- **investment planning**
- **tax planning.**

Trust companies were easily distinguishable from banks in this regard.

During the same period, print advertisements for banks show a concentration on:

- **savings accounts**
- **chequing accounts**
- **personal loans.**

The Sellers and Their Products Have Changed continued

This clear separation of institutions by product and function has largely disappeared. Many trust companies now offer the following list of products and services:

Savings and Chequing Accounts
Guaranteed Investment Certificates
Term Deposits
Registered Retirement Savings Plans
Equity Funds
Mortgage Loans
Investment Advisory Services
Estate Analysis and Planning
Trust Fund Management
Stock Transfer Services
Deferred Profit Sharing Plans
Registered Retirement Income Funds
Personal Loans
Portfolio Management
Commercial Loans

To the financial industry:

"Educate consumers in seminars."

Consumer - Calgary

Many of the services on this list are virtually indistinguishable from those currently offered by banks.

The duplication in products and services offered by banks and trust companies is but one example of the change in the financial marketplace. Currently banks, securities firms, insurance companies, treasury branches, credit unions, and trust companies offer many of the same products and services.

Competition Has Increased

Because an increasing number of institutions are offering basically the same products and services, the competition for the consumer savings and investment dollar has increased dramatically. As competition increases, marketing is becoming more pervasive and aggressive.

Competition Has Increased continued

The drive for a larger market share has promoted the development of more sophisticated savings and investment instruments. Mutual funds and similar instruments are aggressively marketed by all sectors of the financial marketplace. The competition for the retirement investor is particularly intense. For example, Registered Retirement Savings Plans come in various guises. Funds can either be *'saved'* or *'invested'* in various ways. Investment decisions can be made either by the institution or the Registered Retirement Savings Plan holder. Registered Retirement Savings Plans have in turn led to the creation of Registered Retirement Income Funds. These too can either be managed by the institution or self-directed by the consumer.

Corporate Concentration Has Increased

Concentration of financial power is another attribute of the current financial marketplace. The reregulation which led to the dismantling of the *four pillars* has also led to the creation of large financial conglomerates, both national and international in scope. Some of these conglomerates are made up of many of the various types of financial institutions.

Currently, it is possible for a consumer to sell a house, secure mortgage financing for a new home, arrange to have the mortgage life-insured, open a savings account, transfer a Registered Retirement Savings Plan, and buy stock, all through the same firm or by using the services of related firms. Such interconnections between institutions play an important role in blurring previously clear institutional lines as well as increasing competition. As a result, it can be difficult for consumers to determine from whom they are buying what.

The Concerns of Government

The increasing complexity of the new financial marketplace has been of ongoing concern to Alberta Consumer and Corporate Affairs Minister, Elaine McCoy. The minister is concerned that perhaps consumers no longer have all the tools required for making effective savings and investment decisions. As a result, the minister wanted to determine if the changed regulations and safeguards of the traditional financial marketplace were capable of governing the transactions of the present and future. If current regulations and safeguards were found to be inadequate, changes would have to be made which were in keeping with current realities.

To Consumer & Corporate Affairs:

"Tell companies to regulate themselves or the government axe will fall."

Investor - Wetaskiwin

Determining the Need for New Regulations

The minister sought the advice of a number of individuals who were both well-informed and concerned about the current state of the financial marketplace. These individuals were drawn together as the *Ministerial Advisory Committee on Fair Dealing in Consumer Savings and Investments.* The minister asked the Committee to examine the full range of financial products and services being offered to consumers. She requested recommendations for action which took into account the current realities of the Alberta financial marketplace

Maintaining a Fair Financial Marketplace

The minister's vision of the fair financial marketplace is one which offers the necessary safeguards for the consumer, but does not unfairly restrict the healthy competition among sellers of financial products and services. It is the minister's intention to help maintain such a fair financial marketplace.

3.2 The Interaction of Technology & Products

Overview

The interaction between technology and new savings and investment products became quite clear to the Committee as it carried out its work. The technology itself has made possible more complicated and sophisticated products. However, once in place, these new products help justify the economics of the technology and in turn create a demand for further innovations. This *technology - product - product - technology* cycle is a driving force in the current financial marketplace. Its impact on marketing and the resulting effects on consumers cannot be overestimated.

The Unpredictability of Technological Developments

Computer-based technology has developed rapidly and in previously unforeseen directions. This is especially true in the financial industry. As a result, it is impossible for anyone to guess what route technology may take in leading to the development of new savings and investment products.

The process of human interaction with new technology also makes it difficult to construct a long-range forecast as to which technology will be used to deliver which kinds of products. Regulators are perhaps among those less well-equipped to determine what this human interaction is likely to be. Their focus is on what is, rather than what will be or might be. Once a new technology is available, people often react to it in unforeseen ways. This in turn gives rise to yet more opportunities for product development.

The Customization of Products

One of the current marketing approaches being used by the majority of financial institutions is to customize their particular product within a competitive product range. For example, there are different rates of return on various levels of savings in a particular type of savings account. As has been the case for several years, interest on savings is calculated on a daily-balance basis. Neither arrangement would have been practical without a computer. The net effect of this type of customization is that the consumer may have a choice of different features on the premium savings account available at each of several institutions. As a result, the decision as to which account to choose is more complicated and difficult.

To the financial industry:

"Don't promise what you can't deliver."

Senior - Calgary

The Personalization of Products

The use of the computer to sell financial products is constantly increasing. Life insurance agents, financial planners, and others are all using computer printouts, customized to the situation of an individual investor, to sell their products. For example, banks are planning the use of personal computer-based programs which will allow the emerging generation of *personal bankers* to customize their advice to the specific needs of the client. Client data will be fed into the computer and it will recommend which types of accounts and other products the consumer should have. The potential persuasiveness of a result which uses personal data and which is so neatly presented is substantial. In addition, the creation of a comprehensive personal information file on individual consumers creates the potential for misuse of confidential consumer information. The potential for misuse of this information is heightened by the dismantling of the *four pillars* and the growth of financial conglomerates.

The Sale of the *Complete Package*

It is likely that the use of technology will tempt institutions and individuals selling financial products to offer an *all round* type of service. This is what many individuals and institutions do, or claim to do, today. It is possible that we will see an explosion of available software and databases which will allow sellers of financial advice to compare products which may be of interest to the client, prepare financial projections, and perform similar types of financial analysis. The problem here is that the advice coming out of the machine is only as good as the quality and range of variables, options, and data which went in.

The Sale of the *Complete Package* continued

It is well worth noting the GIGO acronym used by computer specialists: *"Garbage In - Garbage Out."* The consumer who consults a financial professional should recognize that the advice received is only as good as the training and experience of that professional. Likewise, the advice received from a computer program will be only as good as the diligence with which the program was prepared. No computer program can ever take into account all the factors which a human being might when interviewing a client.

The *High-Tech High-Touch* Combination

The modern sales relationship and personal banker relationship involves a high use of technology. These can be intensely personal relationships nonetheless. As a result, these relationships are often referred to as *high-tech high-touch.*

The transaction relationship involves the high use of technology but little personal contact. It appears that financial institutions will continue to divide their activities more and more clearly into sales relationships and transaction relationships. This would not be possible if the computer were not there to assist on the transaction side. The use of the computer on the salesperson/personal banker side can also be expected to grow.

Changing Regulation for Changing Technology

It is more than plausible that within a few years consumers will be using telephones and personal computers at home to examine the investment options available to them. This introduces a whole set of disclosure issues. How will regulators ensure adequate disclosure has been made when consumers interact only with a screen? The current and future impact of technology is a clear indication that regulation must be dynamic because the environment is dynamic. The regulatory system must be flexible and responsive to changes in the market. Without a responsive and adaptable regulatory process, it will be impossible to provide adequate consumer safeguards.

3.3 The Retirement Investor

Retirement Investors Require Special Safeguards

The Committee believes that the situation of the retired, or soon to be retired, investor is a special one. The consumer who has retired from full-time employment or who will be doing so shortly has options for investment of retirement funds which are often newly developed and which require a set of complex decisions.

> *"I prefer savings because you know it's yours, and it's going to be yours for a long time."*
>
> **Consumer - Calgary**

Recent tax changes have made Registered Retirement Investment Funds (RRIFs) much more flexible vehicles than they were previously. In addition, the aging of the population has made the retirement investor a prime target market. As a result, many financial institutions are beginning to compete more actively for RRIF funds. Because the market has developed rapidly, many novel investments are available through RRIF's and other means.

Retirement Investor Decisions

The retirement investor faces a particularly crucial and complex set of decisions because of two major factors:

1. **The investor's assumptions about the future will have a great deal to do with the selection of a particular investment strategy. The retirement investor usually lacks the ability to use future earnings to make up for losses or poor returns.**

2. **Retirement investors must make assumptions about their own future needs which are once again crucial because of the relative permanence of the decisions taken.**

For both these reasons, the flexibility in any investment vehicle is especially significant.

Requirements of Retirement Investments

The following characteristics of retirement investments are also particularly crucial:

- **security**
- **liquidity**
- **cash flow**
- **yield.**

Security. Because investment funds will become the source of the consumer's livelihood, a loss is much harder to absorb. The inability to replace lost funds through future earnings means that the retirement investor is at greater relative risk than someone who is still in the workforce.

Liquidity. The availability of funds is important in the event of unforeseen dramatic changes in the life of the retiree such as serious illness or the death of a spouse.

Cash flow. Growth investments are often unsuitable for many retirement investors because retirement investors require regular cash flow for living expenses.

Yield. Investments with no opportunity for protection from increases in inflation are especially risky for the retirement investor who will rely on these investments for future living expenses.

The Magnitude of Retirement Investments

The magnitude of retirement investments is an important factor in considering the protection of the retirement investor. For many individuals investing in preparation for or during retirement, the number of dollars greatly exceeds any single investment they have made in the past. They are often unaccustomed to dealing with the implications of investing large sums of money.

Financial Institutions Want Retirement Investments

Compounding the significance of the size of the investment is the fact that the retirement investment is a significant sum in absolute terms. The people holding these accumulated funds are a prime target market for financial institutions and sales personnel. While advice offered by the institution or salesperson to the retirement investor may well be sound, it can be primarily motivated by the attractiveness to the institution of the large sum involved.

Financial Institutions Want Retirement Investments continued

In addition, once a commitment has been made with that sum, there is a reasonable chance that the consumer will never again make a financial move with a sum of this magnitude. Therefore, there is more pressure for the industry to sell a product at this moment than in many other situations.

To the financial industry:

"Be honest and maintain staff who are also honest."

Consumer - Edmonton

Investing Under Stress

It must be remembered that the beginning of retirement is often a time of great stress for the individual. A lifetime of working habits is changing. The existence of retirement funds to invest is often indicative of a lifetime of hard work and thrift. This period of employment, productivity, and financial growth is coming to a close. The future holds many changes which may be seen as uncomfortable and uncertain.

Uncertainty and change are among the most stressful factors in anyone's life. Accordingly, the retirement investor may be particularly susceptible to high pressure sales tactics. It is for these reasons that the Committee feels the retirement investor requires special safeguards, such as time to consider retirement investment products.

3.4 Maintaining a Fair Financial Marketplace

Definition of the Fair Financial Marketplace

The fair financial marketplace is one in which:

- **consumers can prepare themselves effectively**
- **all necessary information is available and usable**
- **the quality and suitability of financial products is readily determined**
- **industry personnel are competent and ethical**
- **risks are clear.**

Regulatory Changes Are Needed

Changes in the nature of the financial marketplace make changes in its regulation inevitable. What those changes should be, and who should do the regulating, was the primary concern of the Committee.

Consumer confidence in the integrity of the system is an essential element of a fair financial marketplace. Regulation plays an important role in helping to maintain that confidence. Fair dealing between producers and purchasers in the financial marketplace is in the best interests of all concerned.

The Delivery System Shouldn't Be a Source Of Risk

Consumers of financial goods and services must have freedom of choice. They must be free to choose a highly speculative (hence, risky) stock, to take less risk on a blue chip issue, or to choose a low-risk item such as an Alberta Capital Bond.

The financial marketplace will always involve a degree of risk-taking. However, risk should only result from the unpredictability of the performance of the marketplace itself. The delivery system for the financial products and services offered should not be a source of risk. There should be no risk in the way funds are handled or the way commission motivation is disclosed. For example, it is not acceptable that a consumer be tricked or persuaded into buying an uninsured product when the consumer intended to purchase an insured deposit.

The Risks of the Financial Marketplace

The terms *retail* and *consumer* can be somewhat misleading when used in relation to the financial marketplace. Their use may imply that the financial marketplace has the same aspects of the general marketplace and that the rules, regulations, and approaches which are used in one can be applied to the other. Such is not the case.

> To the financial industry:
>
> ***"Advise individuals on the financial position of your company, and its prospects for the future. Give honest advice not based on commission expectations."***
>
> Consumer - Edmonton

The risk factor for the consumer in the retail savings and investment marketplace is much greater than in the general marketplace. There are few, if any, products and services in the general marketplace which pose as great a potential risk to the consumer's present and future financial security as do some financial products. The consequences of a mistake in judgement or a failure of a product to perform as advertised are normally not as serious and remedies are often more readily available. As a result, consumer savings and investment products and services require greater scrutiny and a greater degree of regulation.

Consumers Must Have Confidence in the Marketplace

To have confidence in the financial marketplace, consumers must understand the risks they are taking and be protected from risks which are unnecessary. A marketplace which the public believes to be full of tricks and traps - deliberately set or not - will not be able to attract consumers' savings and investments.

Consumers Need Specific Types of Information

A fair financial marketplace operates on the premise that consumers need and want certain information which sellers are obligated to provide. Only well-informed consumers can make the effective, responsible decisions in which business people deal. An honest description of the products and services offered is the only basis for a fair business deal.

Language Must Be Clear With Fixed Definitions

To maintain a fair financial marketplace, consumers must be told in clear, simple language exactly what is contained in a product. The *ingredients* should be provided in writing using readily understood terms. No hidden *additives* should be allowed.

Consumers Must Know the Risks They Are Accepting

In a fair marketplace, consumers must know whether a product is insured and how secure it is, since these factors could affect the desirability of a deposit or investment.

Consumers Should Have the Right to Reconsider

A fair financial marketplace recognizes that some types of financial transactions have a significant impact on the investor. For example, retirement investors often must depend on their investments for the rest of their lives. At the same time they are making their investment decisions, they are often experiencing extensive life changes and high-level stress.

A fair financial marketplace allows these vulnerable consumers a period of time to rethink some types of transactions before they are bound by them.

Consumers Must Have the Assurance of Product Reliability

Throughout this report, the Committee acknowledges that consumers are their own best protection in the financial marketplace. They are obligated to make reasonable and informed decisions. However, it may be that some products and services in the financial marketplace are so complex that consumers' ability to master every aspect of a financial transaction is severely limited. A fair financial marketplace must be structured in such a way that consumers are able to rely on the quality of products and services.

Consumers Must Be Assured of the Quality of Personnel

In a fair financial marketplace, the quality of personnel is assured. This allows consumers to assume that the personnel upon whom they rely are well-trained, ethical, and effectively supervised. In addition, consumers must be able to assume personnel are competent to perform well the tasks they undertake, which include not just selling, but assessing the suitability of the product in relation to the needs of the consumer. For example, a suitability rule has been imposed by the securities industry on its members for some time now.

To Consumer & Corporate Affairs:

"Consult with consumers and industry to develop regulations."

Investor - Wetaskiwin

Consumers Must Be Able to Expect Ethical Behaviour

The very nature of consumer savings and investment transactions, and related financial advice demands that depositors entrust funds to an institution and ask it to make a variety of decisions about security, yield, and risk for them. Consumers have a right to expect that the institutions and individuals who play a role in these transactions merit that trust by operating with the highest standards of ethical conduct.

Consumers Must Know the Results of Institutional Failure

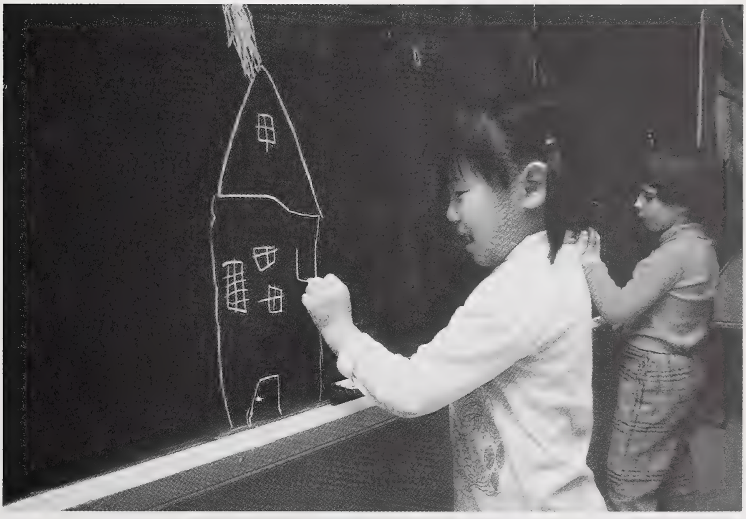
No institution can be absolutely safe from financial difficulty or even collapse. In a fair financial marketplace, savers and investors may or may not bear the full burden of that risk, depending on the nature of the investment. Regardless of the situation, consumers should be told what their risks are, as well as what risk is shared by the institution, by those who control the institution, and by any insurer.

Consumers Must Know the Vested Interests of the Sellers

In the fair financial marketplace, the consumer is aware of what commission or payment the financial advisor receives for a sale. In addition, the buyer is told by the seller of any relationship between the seller and the product.

4.

Consumer Learning Resources



4.1 Overview

Current Situation

Industry and government have access to a wealth of information relating to financial products and services. This is in great part due to the role they play in approving and developing products and services as well as the range of human and information resources at their disposal. At present, it is difficult for consumers to develop the same level of expertise and access the same types of information.

To Consumer & Corporate Affairs:

"Put some type of information course into school programs, with qualified people."

Teenager - Edmonton

Throughout this report, the Committee has maintained that consumers are their own best protection in the financial marketplace. However, the Committee has also acknowledged with equal emphasis that information and education are the keys to this self-protection.

Dynamic Partnership Based on Consumer Learning Resources

The dynamic partnership of government, industry, and consumers discussed in this report cannot be achieved unless consumers can make themselves aware of how the financial marketplace currently functions. Given the rate of change in the financial marketplace, consumers must also be able to upgrade their knowledge. The Committee believes these goals can be achieved through:

- **instruction in schools**
- **instruction in the workplace**
- **advertising**
- **instruction at the time of purchase**
- **regulation of financial advisors.**

4.2 Creating an Educational Task Force

Current Situation

Government and industry have the resources and knowledge with which to develop courses and materials for ongoing consumer education. No other bodies have the same level of expertise and experience in dealing with the emerging financial supermarket. In addition, government and industry are best able to ensure that educational materials are kept up-to-date and reflect current market realities.

Recommendation:

The Committee recommends establishing a joint industry and government educational task force to set goals for consumer education for the coming year and for a three-year and five-year time frame.

The task force should take an inventory of the courses and publications which are presently available for consumer education in the retail financial marketplace. The task force should determine where gaps exist and recommend a course of action for development of further course materials and publications as needed.

The task force should also consider whether an industry-sponsored *telephone hot line* should be created in conjunction with government. The Committee recommends that if such a *hot line* is created, it should dispense factual information and make referrals to courses and publications only. No advice should be provided.

4.3 Providing Instruction in Schools

Current Situation

Knowledge of the retail financial marketplace is fast becoming an important life skill. However, in Alberta's classrooms there appears to be little emphasis on developing the skills young Albertans will need to act critically and intelligently as consumers of financial products and services.

Lack of Financial Education Puts Young Consumers at Risk

Students leaving the school system appear to lack the skills necessary to ask the right questions, ensure that all necessary information is received, make balanced judgements about financial products and services, and manage their financial resources. There should be increased emphasis in schools on the basic skills needed to cope with a financial market which is constantly changing.

Most people do not pursue any education in financial matters after finishing high school. Yet those starting out in adult life require the skills necessary to ensure their savings are protected. Investments must be made in accordance with their own objectives and with the least risk of loss or waste of funds through the process of acquiring the investment. Understanding how to set financial objectives and how to attempt to meet them are such crucial skills that they must be taught in school rather than being left to chance afterward.

Recommendation: Every effort should be made to raise the profile of training in the basic components of a financial product or service. The Committee believes the Department of Consumer and Corporate Affairs should continue to work in conjunction with the Department of Education to develop goals for the teaching of *financial shopping skills* to high school students. It would also be desirable to examine the junior high school curriculum and to determine how these skills could be introduced there as well.

4.4 Providing Instruction in the Workplace

Current Situation

The great majority of adult Albertans are employed in full-time work. In addition to their workplace duties, many Albertans have the obligations which come with raising families. As a result, it is often difficult for these individuals to attend evening classes.

Recommendation: The Committee believes it is appropriate for learning resources to be made available in the workplace through self-study courses, lunch hour sessions, and the like. Therefore, the Committee recommends that the proposed industry/government educational task force consider how learning resources might best be made available through the workplace.

4.5 Setting Standards for Advertising

Current Situation

The Committee believes it is important to recognize the impact of all forms of product promotion (brochures, newspapers, television, radio, etc.) when used as a means of dispensing information to the consumer. Except for the sale of regulated securities, there are currently no required standards in advertising content or presentation when promoting financial products or services.

Recommendation:

The Committee recommends that there be a general requirement for fairness and truth in advertising in the proposed *Consumer Savings and Investment Information Act*. Any such regulation should not require government to pre-screen advertisements.

The creative and changeable nature of product promotion makes it difficult, and perhaps impractical, to draft specific regulations regarding the advertising of the complete range of existing and future financial products and services. However, the Committee believes advertising must be subject to some form of regulatory requirement.

4.6 Providing Instruction at Time of Purchase

Current Situation

The Committee believes that an important portion of what the consumer learns about financial products occurs when a buying decision is about to be taken. It is reasonable to assume that the consumer who is ready to make a deposit or an investment, or use a financial service, is extremely interested in information about the product or service.

Recommendation:

The Committee has recommended a requirement respecting advertising [page 48] and has made several recommendations concerning the substance and form of information and contractual documents [pages 60 through 66].

Implementing these recommendations should help better prepare consumers. However, there is always the chance that the consumer will still be inadequately prepared when a financial transaction is undertaken. As a result, the time of purchase should be seen as a *teachable moment.* Sales materials used by the industry should be created in such a way that the seller must guide the consumer through the various steps involved and the decisions which must be made. This explanatory approach should make consumers aware of the magnitude and possible effects of the financial decisions they are taking.

4.7 Financial Advisors

Overview

The Committee has come to recognize the financial advisor as a key source of consumer learning. In many cases, the financial advisor may be the most readily accessible source of learning. In addition, the advisor can interact with the consumers as learning progresses. The advisor also has the advantage of commenting directly on the consumer's individual situation.

Concerns Regarding Financial Advisors

The Committee recognizes that the use of an advisor has great potential for consumer learning. It is, therefore, concerned that the learning opportunities are of as uniformly high quality as possible. For this reason, the Committee has recommended that all financial industry personnel who provide any advice to consumers be subject to common minimum standards of training and behaviour. These standards are detailed in the Committee's recommendations on standards for the industry [page 99] and are dealt with further in respect to regulation of financial planners [pages 75 through 78].

To the financial industry:

"Represent your business fairly and accurately to consumers."

Investor - Calgary

The Committee is particularly concerned about the largely unregulated group of *financial planners* in the marketplace. This group has potential to provide customized financial advice even to consumers of modest means. Because of this, this group also poses a potential danger if personnel are not well-trained and required to adhere to a suitable code of ethics. Accordingly, the Committee has made several recommendations respecting a regulatory framework for financial advisors, including financial planners [page 99].

The Committee believes that certain information regarding financial advisory and sales personnel is so crucial that it should be provided to consumers under requirement of law. Therefore, the Committee has recommended this as part of the proposed *Consumer Savings and Investment Information Act.* Recommendations respecting qualifications of sales personnel and their compensation are found on pages 67 through 69.

Duplication of Regulation Is Not Desirable

The Committee recognizes that there is a cost to the industry and therefore to the consumer as well if duplication of regulation occurs. Accordingly, the Committee supports the creation of an environment in which all financial advisors are subject to a minimum common standard of regulation but where no financial advisor is required to be registered twice.

5.

Consumer Access to Information

5.1 Overview

The Consumer's Need for Information

The Committee believes that when consumers are given enough appropriate information, they are willing and able to make informed financial decisions. The Committee's focus testing with consumers appears to support this position.

Information is the key to accurately determining the financial risks consumers are taking as well as the actual and potential rewards they will receive. However, the investigations of the Committee have indicated that not enough information is currently available for this objective to be achieved.

The Quality and Presentation of Information

Simply asking the financial industry to provide specific information to consumers will not create the proper environment for informed financial decisions. If equivalent information from all sources is not similar in content, language, and format, it will be of little use to consumers. Informed financial decisions require close examination and cross-comparison. A lack of consistency in content, format, and wording makes cross-comparison virtually impossible. In addition, if this information is not produced in a highly readable form, its usefulness is severely diminished.

Scope of Consumer Savings and Investment Information Act

One of the major recommendations of the Committee is the drafting of a *Consumer Savings and Investment Information Act*. This *Act* would spell out clearly, both to the financial industry and consumers, the nature and quality of financial information all vendors of financial products and services must make *available*. The general standards outlined in this proposed *Act* are not intended to override standards of a more specific nature. For example, the *Securities Act* contains disclosure standards to be followed when trading in securities. Since the required disclosure under the *Securities Act* is more detailed and onerous, the activities, including secondary trading, regulated by the *Securities Act* should be exempted from the provisions of the proposed *Act*.

Section Content

This section of the Committee's report outlines the guiding principles of the proposed *Consumer Savings and Investment Information Act* and its suggested provisions. Industry input into the *Act* and how the public should be made aware of it are also discussed. Each of the areas the Committee feels the *Act* should address and the rationale for doing so are also provided in this section.

5.2 Creating a Consumer Savings & Investment Information Act

To Consumer & Corporate Affairs:

"Explain your limits to the public in simple, understandable English."

Consumer - Edmonton

Principles of Proposed Act

Most consumers, through the application of their education, experience, and common sense, are able to make decisions about risk and return. In order that consumers can make informed choices about the risks entailed in financial products and services, it is the Committee's opinion that the consumer must receive *common sense* information. It is also the Committee's opinion that the proposed *Act* should establish three general standards governing the flow of information from the financial industry to the consumer:

1. **Information should be useful in form and content.**
2. **Information should be accurate in all respects.**
3. **Information should be sufficient to allow an informed decision.**

Provisions of Proposed Act

Further to these three general standards regarding the flow of information from the financial industry to the consumer, the Committee recommends that the proposed *Act* contain the following provisions:

1. **Those compensation arrangements which may affect advice given to the consumer should be disclosed to the consumer before any transaction is undertaken and at the time any recommendation is made.**
2. **The qualifications, formal education, training, ongoing education and experience of a financial advisor should be disclosed to the consumer.**
3. **Any cross-selling or networking arrangements should be disclosed to the consumer.**
4. **All financial information provided to the consumer should be current, reflecting any material change that might affect the decision of a reasonable consumer.**
5. **All material information relevant to the decision of a reasonable consumer in purchasing any financial product or service should be provided.**
6. **All material information relevant to the decision of a reasonable consumer should be provided to the consumer prior to the completion of any financial transaction.**

Provisions of Proposed Act continued

7. **All material information provided to the consumer should be in a clear and coherent manner consistent with the reasonable expectations of a financial consumer.**
8. **A cooling-off period for a specified period of time should be provided during which the consumer has the right to rescind in writing certain contracts.**
9. **All advertisements for financial products and services should be required to both be true and not misleading.**
10. **All consumer information received by a seller of financial products and services should be kept strictly confidential and only used for the purpose for which it was given.**

Language of Disclosure Information

The *Act* should regulate the language to be used in any documentation which relates to a financial product or service and which the consumer is required to sign. The following guidelines should be used:

1. **use of simple, readily understandable language in the context of its usual and everyday meaning**
2. **other than the required disclosure under this *Act*, the document should contain only those terms essential to the relationship of the parties in the transaction.**

Sanctions for Breach of the Act

The Committee is of the opinion that there must be adequate sanctions dealt with on a very timely basis if any of the provisions of the *Act* are breached. This is especially true where such a breach results in loss to the consumer. These sanctions should include:

1. **a general prohibition against any representation which would reasonably have the effect of deceiving or misleading a consumer or putting undue influence on a consumer**
2. **a civil right of action on a class basis allowing government to participate**
3. **meaningful monetary and imprisonment penalties for failure to comply with the provisions of the *Act***
4. **specific disciplinary sanctions including cancellation or suspension of license, fines and/or imprisonment for those who contravene the *Act*.**

Recommended Mechanism for Consumer Redress

Beyond these sanctions, the Committee believes the *Act* should set out a simple, quick, and inexpensive redress procedure. This procedure would give consumers a *user friendly* mechanism, through mediation/arbitration services, to attempt reimbursement for a loss suffered.

The following general options should be considered for developing a mechanism for consumer redress:

1. **establishing a means of resolving disputes through mediation and arbitration and giving a complainant the option of using this procedure**
2. **establishing a mediation/arbitration service and indicating in the legislation any complainant is at liberty to use such a system**
3. **allowing the government discretionary power to delegate this mediation/arbitration function to an appropriate Delegated Regulatory Organization**
4. **making all financial transactions subject to an arbitration system.**

5.3 Industry Role in Creating a Consumer Savings & Investment Information Act

Current Situation

Some industry groups have expressed frustration with not being consulted when new legislation affecting them is being planned.

Without Industry Input, Consumers Are at Risk

Without industry participation in its development, consumers may not have the advantage of workable disclosure as quickly as possible. Industry participation in the development of standards for disclosure is both appropriate and desirable. Industry participation will make legislative initiatives more effective and more immediately useful to the consumer.

Recommendation:

The Committee recommends the formation of a joint industry/government task force to expedite the preparation of the proposed *Consumer Savings and Investment Information Act.* This task force might also be usefully charged with obtaining industry comment on proposed changes to other legislation, such as the *Securities Act* and the *Mortgage Brokers Regulation Act,* and related regulations.

The Committee is firmly committed to communication and cooperation between industry and government to ensure that consumer safeguards are implemented as efficiently as possible [see also, page 115].

5.4 Advertising the Provisions of a Consumer Savings and Investment Information Act

Current Situation

Consumers often have to learn of disclosure requirements by trial and error.

Without Full Knowledge, Consumers Are at Risk

Consumers may not realize they are not receiving information which is required to be disclosed. Consumers must be aware of the information which they are entitled to receive from anyone selling financial services or products to them. As a result, consumers should be made aware as quickly and fully as possible of the information they are entitled to receive under the proposed *Consumer Savings and Investment Information Act.*

Recommendation: The Committee recommends all disclosure requirements under the proposed *Consumer Savings and Investment Information Act* be advertised extensively before and after its implementation.

5.5 Use of Plain Language Documentation

Current Situation

For the most part, material which is used to advertise financial products and services is quite easy to read. However, much of the contractual material which is used to explain and limit the various aspects and functions of these same products is not. This material tends to be laden with densely packed sentences, industry jargon, and legal terms.

To Consumer & Corporate Affairs:

"Make sure the information is clear so the consumer knows what he is buying.'

Investor - Wetaskiwin

Without Plain Language, Consumers Are at Risk

The average North American reads at a grade 9 level. This means the majority of North Americans read with the vocabulary and comprehension of grade 9 students. This fact is indicative neither of intelligence nor financial acumen, but merely of reading skill.

Recent readability studies indicate that a sentence of 30 words or more is incomprehensible to 53% of the North American reading public. Other studies indicate that perhaps 20% or more of the Canadian public is functionally illiterate. This means that 1 out of 5 Canadians reads at a grade 6 level or below. In addition, in Alberta 12% of the population speaks English as a second language and may or may not have highly developed reading skills in English.

A random survey of non-advertising materials related to financial products and services indicated a readability level of college graduate and above. This means that such material may be incomprehensible to the majority of depositors and investors. Yet it is on this material which their investment and deposit decisions will be made. Incomprehensible language in such material forces the consumer to place undue reliance on the advice of sales personnel and financial advisors. It also makes cross-comparison of products and services virtually impossible.

Recommendation:

The proposed *Consumer Savings and Investment Information Act* should require that contractual materials related to financial products and services be written in such a way as to be readily understandable to the majority of Albertans. Industry recognizes that there are benefits to be gained for itself and the consumer by doing so. For example, the Canadian Bar Association and the Canadian Bankers' Association have recently formed a joint committee to examine the feasibility of greater use of plain language in the financial services industry, especially in the banking sector.

Government and industry should work together, and with such initiatives as the joint Banker/ Bar Association Committee, to establish an acceptable readability formula which can then be applied to all contractual documents related to consumer financial products and services.

5.6 Use of Generic Product Labelling

Current Situation

More financial products are available today than ever before. The number of new products, and new combinations of familiar products, grows every day. Descriptions of these products by various institutions are inconsistent. Different institutions often use the same wording to describe different products. Often, different wording is used to describe substantially the same product. In addition, not all products carry thorough descriptions. As a result, it is often not clear to consumers what they are being offered.

Without Generic Labelling, Consumers Are at Risk

Without sufficient information, consumers risk purchasing products which are unsuitable for their requirements. There is also a risk that a product may (either intentionally or not) look like some quite different product because of the way it is presented.

For marketing reasons, a seller may want to call a Registered Retirement Savings Plan (RRSP) a *Tomorrow Builder*. The ability to do so should not be compromised. However, where appropriate, somewhere on the product, the product should be described as *"a self-administered RRSP with options for investment of funds including term deposits. These are offered by the Universal Bank. Guaranteed Investment Certificates are offered by Unimort Mortgage Corporation (a subsidiary of Universal Bank) and three different mutual funds managed by Unibank Investment Management Ltd. (a subsidiary of Universal Bank)."*

In the age of the financial supermarket, the shopper must have easy access to clear information about what is available. This means products must be labelled by their generic contents.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should provide for labelling of financial products and services, which includes generic descriptions of what they are.

5.7 Use of Standardized Terminology

Current Situation

Terminology now used in product description and sales is often inconsistent. The meanings of terms change in different situations and new terms with uncertain meanings are invented as marketing tools. Terms such as those shown below are used commonly, but nuances of meaning can mislead the consumer:

- **guaranteed**
- **secured**
- **insured**
- **assured.**

Without Standardized Terms, Consumers Are at Risk

Consumers risk purchasing unsuitable products because of an inability to decipher the language used or because of a misunderstanding of differences in regulation. A complex market requires clearly identifiable products and services. This is impossible without the use of terms whose meaning is precisely defined. The consumer must be able to understand what is being said and must be able to readily determine the exact meaning of certain important terms.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should define certain key terms which are critical to the consumer and require them to be used in a consistent manner.

5.8 Use of a Standard Disclosure Format

Current Situation

Currently, consumers encounter widely different presentations of what is really equivalent information. As a result, it is more difficult than it needs to be for the consumer to sort out which elements of a particular deposit or investment product at one institution are comparable to the same elements at another institution.

Without a Standard Disclosure Format, Consumers Are at Risk

Today's financial marketplace contains a confusing array of products and services. The consumer should be able to sort one from another on the basis of intrinsic merit rather than attractive, and perhaps misleading, packaging. The consumer may wish to take risks with investment funds, but should not be taking risks because of the difficulties of comparing one product to another.

A consistent format for disclosure of information would make the information more useful and easier to digest. A consistent format would also reduce the risk of confusion and inaccurate comparisons between products. The current situation creates the risk that the comparison is incomplete or inaccurate because the process is made complex or misleading by differing disclosure formats.

Recommendation: Where not already required by other legislation such as the *Securities Act*, the proposed *Consumer Savings and Investment Information Act* should require that the basic elements of all savings and investment products be disclosed in a consistent manner.

5.9 Providing Timely Financial Information

Current Situation

The investigations of the Committee brought to light cases where financial information relevant to a transaction was not provided to a consumer until after the transaction was completed.

Lack of Timely Information Puts Consumers at Risk

When the consumer does not have all the significant financial information respecting a product or service before committing to the transaction, the possibility of choosing the wrong product increases. The consumer's ability to make an appropriate decision is related to the completeness of the information used in making it.

Maintaining a fair financial marketplace demands the consumer be provided with complete information before making an irrevocable decision. The advantageous position of the financial institution or professional must not be used to invite consumer transactions based on inadequate information.

Recommendation:

The proposed *Consumer Savings and Investment Information Act* should require that all disclosure of financial information take place **before** the transaction can be completed. The format for disclosure should provide evidence that this has been done. Failure on the part of a provider of financial services to do this should carry the possibility of voiding the transaction. Where the disclosure appropriately includes information about the financial position of the issuer, audited financial statements should form the basis of the information provided.

5.10 Providing Up-to-Date Information

Current Situation

To be useful, all financial statements given the consumer must be the most recent available. In addition, all documents describing the institution should be up-to-date in all material aspects. However, the investigations of the Committee revealed cases where, when currency of information was not prescribed by law, consumers were provided with outdated information.

Without Up-to-Date Information, Consumers Are at Risk

Consumers are clearly at risk if the information they have does not reflect the actual circumstances in which transactions are made. In some cases, the only rationale for providing outdated information is that the current information would have a negative impact on a potential sale.

Recommendation:

The proposed *Consumer Savings and Investment Information Act* should require that consumers are entitled to receive upon request financial statements of any person or institution who will have possession of their funds. To be useful, this information must be up-to-date. Therefore, the Committee recommends that the standards of currency for financial statements required by the *Securities Act* be used as a starting point for discussions in this respect.

Financial statements must contain a balance sheet, statement of income, statement of retained earnings, and if audited, an auditor's report.

Audited annual statements must be available, within 140 days of year end.

Recommendations:

The proposed *Consumer Savings and Investment Information Act* should require that all information provided about the financial health of an institution and about the products which an institution or an individual offers be updated whenever a significant change in this information occurs.

The financial industry should take part in developing rules and a format for updating this information. This will help ensure its effective and speedy implementation. The format should be tested by consumers for ease of use before being implemented.

5.11 Disclosing Qualifications of Sales Personnel

Current Situation

It is the industry's responsibility to inform the consumer about the qualifications of its sales personnel. Currently, there is very little meaningful disclosure of this information. As a result, the public has no basis for evaluating the relative expertise of financial service personnel.

Financial industry personnel have begun to act as professional advisers and have encouraged consumers to think of them as such. In doing so, they assume an aura of knowledgeability and reliability.

Without Knowing Qualifications, Consumers Are at Risk

Often the salesperson can and does offer more than one product or service to the consumer. In most cases, the salesperson will also offer financial advice to the consumer. Because of the confusing array of different initials (or lack thereof) after the names of those selling financial products and services, consumers cannot be sure who has the training most suited to their needs. As a result, consumers risk taking investment advice from someone not qualified to offer it.

Recommendation:

The proposed *Consumer Savings and Investment Information Act* should require clear, straightforward disclosure of the qualifications of anyone performing a financial advice function. This includes not only traditional sales personnel, but counter personnel who advise the public in choosing a product. Such disclosure would form part of the standard disclosure provided to a consumer before a transaction is complete.

Every attempt should be made to create an environment in which the range of qualifications is simplified and standardized. Qualifications should be explained to consumers in a clear and readily-available publication produced jointly by industry and government.

5.12 Disclosing All Relevant Methods of Sales Personnel Compensation

Current Situation

The way sales personnel are compensated is an important piece of information for consumers. Currently, the method of compensation of sales personnel is rarely made clear to the consumer. In some cases, most notably the securities industry, total compensation of the firm and the sales person is disclosed, but compensation arrangements which may affect the motivation of the salesperson are not.

Without Knowing Commission Structures, Consumers Are at Risk

Compensation arrangements vary substantially from one product to another and from one part of the industry to another. Therefore, these arrangements can be a substantial factor in motivating a salesperson to recommend a particular product.

In addition, sales personnel often have a special relationship with one or more financial institutions whose products they recommend. The salesperson may be acting as a true broker or may have special arrangements with one or more companies to emphasize their products or to offer them exclusively.

The consumer may believe, and may be encouraged to believe, that a particular advisor/salesperson is giving independent advice. However, the consumer may incorrectly accept advice as impartial when it is actually influenced by the potential compensation, or other business arrangements, of the salesperson. Without this information, the consumer cannot properly evaluate the advice.

Recommendation:

The proposed *Consumer Savings and Investment Information Act* should require that the details of any compensation arrangements of a person acting as advisor and/or salesperson be fully disclosed to a consumer when any recommendation is given, when these compensation arrangements could affect the advice being provided.

Exemption to Disclosure of Compensation

Disclosure need not be made of portions of the compensation arrangement which have no impact on the advice given. If the adviser or salesperson is on a salary and no volume-based incentive is paid, disclosure of this fact should be sufficient.

Recommendation: Both direct and indirect compensation should be disclosed. In addition, any other relevant business arrangements should also be disclosed to the consumer. Such arrangements might include exclusive licensing arrangements, payment of office expenses, and similar types of arrangement. These provisions should apply to all persons who give advice or sell any financial product to the consumer, including financial planners.

5.13 Disclosing Deposit Insurance Information

Current Situation

Many people choose to save their money rather than invest it because of the inherent risk involved in investments. The majority of these depositors rely on deposit insurance to protect their savings. As a result, consumers must be fully informed about deposit insurance and its limitations. Currently, information on which deposits are covered by some form of deposit insurance is of uneven quality and limited availability. This information is not always well understood, even by many industry personnel.

To Consumer & Corporate Affairs:

"Let consumers know what the rules are."

Consumer - Calgary

Present Canada Deposit Insurance Corporation policy restricts deposit-taking institutions from responding to depositors' questions concerning deposit insurance. The Committee believes this policy should be amended to balance the consumer's right to information, within the context of controls, to ensure these institutions are providing up-to-date and factual information to the public. In this regard, the Committee notes that the financial industry has already taken the initiative and has for some time been actively encouraging the Canada Deposit Insurance Corporation to make the necessary changes.

Lack of Deposit Insurance Data Puts Consumers at Risk

In the current financial climate, deposit insurance has become an important component of consumer decision making. However, the consumer may well receive incomplete or inaccurate information about the extent to which a deposit is covered by insurance or similar protection. There is also a risk that the insurance may be provided by a body which will not be able to meet all claims on it.

The consumer must know who stands behind any insurance scheme, and what their ability is to meet calls on it. In addition, the consumer must be able to learn what the practical outcome will be if an institution fails. Without this information, informed financial decisions are impossible.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should require disclosure of the following with respect to any insurance scheme:

- **the types of deposits which are covered**
- **any deposits which are not covered**
- **the circumstances under which losses are covered (for example, exceptions for fraud rather than normal business losses)**
- **the limits on coverage (for example, maximum amount covered, indication if earnings as well as principal are covered, classes of persons not eligible for coverage)**
- **an indication whether or not coverage is binding on those who offer it (is there any opportunity for participants in an industry fund, for example, to back away from a particular type of loss)**
- **an indication of who is providing the coverage and what financial resources back the fund**
- **a listing of the procedures for making a claim and how long claims take to be settled**
- **an indication if any return is paid on funds between the date of the failure of the financial institution and the date on which a claim is paid.**

The Committee recognizes that the Canada Deposit Insurance Corporation is a federally incorporated body and that provincial governments have a limited ability to affect its operation. However, clear disclosure of deposit insurance provisions is crucial to consumers.

5.14 Access to an Objective Rating Service

Current Situation

Currently, no independent rating service exists covering retail financial products. Discussions with two prominent Canadian rating services revealed that such a service is unlikely to appear in the near future. There are inherent difficulties in rating some types of products and financial institutions.

Without Access to Objective Ratings, Consumers Are at Risk

The consumer does not have the benefit (available to institutional investors) of comparative ratings available for some or all of the products being considered. Without this type of information, informed financial consumerism is difficult.

Recommendation: The Committee recommends the minister consult her colleagues across Canada to determine if there is sufficient interest in a rating scheme to pursue further cooperative study. This challenge is of a very broad scope. Only a concerted national effort on the part of regulators to discuss the possibilities with those who have expertise in this field will make any such service possible.

5.15 Accounting Policies and Audit Reporting

Current Situation

The function of the external auditor does not appear to be fulfilling its role as well as it might from the point of view of protecting shareholders. Accounting policies for financial institutions do not appear to have been standardized. Auditors' responsibilities for reporting to regulators and depositors or investors are not as clear and far reaching as they should be.

Accounting Policies and Audit Standards Are a Concern

The *MacDonald Commission on the Public's Expectations of Audits* raises a number of concerns about the performance of the auditing profession. External auditors have not always provided enough information about the financial difficulties faced by some financial institutions to regulators, depositors, and investors. Therefore, the consumer often lacks the knowledge to assess whether a particular deposit or investment is being placed with a solvent organization.

The financial reporting system, of which accounting policies and auditors' responsibilities are integral parts, plays a crucial role in consumer protection. It must be continually strengthened to meet new challenges.

Recommendation: The Committee notes that the Canadian Institute of Chartered Accountants has established a committee to study accounting policies and standards for financial institutions. The Committee recommends the minister call upon the Canadian Institute of Chartered Accountants to meet the challenges posed by accounting and auditing problems of financial institutions and other entities in which consumers invest. External auditors do not appear to be fulfilling their role as well as they might be from the point of view of protecting depositors.

6.

Consumer Safeguards

6.1 Overview

Current Situation

Throughout this report, the Committee has maintained that consumers are their own best protection in the financial marketplace. Two keys to this self-protection are education and access to certain kinds of information. However, information and education alone are not sufficient to maintain a fair financial marketplace. Given the complexity of the current financial marketplace, a number of areas exist where consumers can only be protected by the existence of adequate safeguards.

> To Consumer & Corporate Affairs:
>
> *"The people have said they want regulations, so figure out how to do it."*
>
> Retirement Saver - Edmonton

Adequate Safeguards Must Be in Place

This section of this report outlines a number of safeguards which are needed to protect the interests of the consumer. The Committee believes it is through the implementation of these safeguards, in conjunction with adequate information and education, that a fair financial marketplace can be maintained.

6.2 Regulating Financial Planners

Overview

Maintaining a fair financial marketplace requires that everyone offering financial advice to the public be subject to regulatory control. Consumers must know that the personnel who sell them advice in the financial marketplace are knowledgeable, up-to-date, and ethical.

There is a need to distinguish between those who offer advice and those who simply perform a clerical function, such as taking an order for a term deposit. Consumers need to be made aware of the qualifications, or lack thereof, of the financial industry personnel with whom they deal. At the same time, those qualifications must meet a uniform minimum standard.

The Standards for Financial Planners Are Uncertain

The number of individuals offering to help consumers plan their financial future is growing. These individuals have a variety of qualifications - some have virtually no qualifications. There is no common training, no certification for eligibility to practice, and no enforceable code of conduct or disciplinary system.

The Canadian Association of Financial Planners has been set up to work toward implementing these consumer safeguards. But membership is voluntary with no ability to restrict the opportunity to practice if a member leaves the organization. In addition, membership is small compared to the army of individuals who represent themselves as financial planners. As a result, the consumer may be receiving advice from individuals whose qualifications are unclear and may be inadequate.

The Compensation of Financial Planners

Many financial planners are compensated on the basis of what products they recommend and sell. The consumer may believe that impartial advice is being given, while the *planner* actually has a financial stake in the decision.

Rates of compensation vary and can act as an inducement for the planner to promote certain products. As a result, individuals who represent their service as independent professional advice may be providing suggestions which are heavily coloured by the monetary benefit to them if a particular product is sold.

Unregulated Financial Planners Put Consumers at Risk

Consumers are receiving important financial advice from individuals whose qualifications are unclear, cannot be judged with any certainty against an accepted standard, and which may be inadequate. Presently, the consumer has no recourse other than civil lawsuit if the financial planner does not act in an ethical manner.

Recommendations:

To provide adequate safeguards for the consumer, financial planners must be regulated effectively. This will require:

- **introducing legislation and/or regulations to govern financial planners**
- **establishing a financial planners' Delegated Regulatory Organization**
- **compulsory disclosure of sales-based compensation**
- **prompt adoption of a voluntary compensation disclosure format.**

Recommendation:

The Committee recommends regulation of financial planners to govern the interaction with consumers of any and all persons who offer personal financial planning advice. Such regulation should encompass all those who prepare personal financial plans, who use personal financial projections to sell their products, and who hold themselves out as being financial planners, whether or not that term is used. The only financial industry personnel who should not be subject to such regulation are those individuals who provide no advice or counselling whatsoever.

The financial planning industry holds itself out to be providers of advice on a *professional* basis. It is essential that they act accordingly. The government should ensure, through regulation, that financial planners operate professionally.

Regulation Should Begin Immediately

It is crucial that financial planners be subject to a uniform and common set of standards of training and behaviour. Therefore, regulation of financial planners should begin immediately, whether or not a suitable organization already exists to assume the responsibilities of a Delegated Regulatory Organization (DRO). However, the Committee recommends consultation with the Canadian Association of Financial Planners (CAFP) to determine whether their organization can form the nucleus of a DRO.

All steps should be taken to promote the existence of an effective DRO, in order to place a greater share of the responsibility for regulation on those who are practitioners. The burden of regulating this area should be shared by those who make their living from it. The CAFP has taken the initiative and may well form a suitable starting point for full-scale industry responsibility as part of overall government promotion of safeguards in this area. Failing this, another organization should be fostered with the objective of becoming a DRO.

No Duplication of Regulation

The Committee notes that there are already a number of regulatory regimes in place for registering persons who provide financial planning services. It is clearly not in the interests of the consumer for there to be an expensive and confusing duplication of regulation of these personnel. Accordingly, the Committee makes recommendations respecting regulation of financial planners only after strongly supporting the notion that such regulation must be integrated successfully into existing regulation for sales and advisory personnel.

As noted earlier in this report, the Committee's desire is to see a common minimum standard of quality advice for the consumer. This minimum standard may well be exceeded by some personnel. However, in all cases, the objective must be to ensure that the standard being met is clear to the consumer. The consequences of failure to meet the standard must be serious for sales and advisory personnel, and consistent among them.

Recommendation: The Committee believes that government should consult with all those who presently practice personal financial planning in order to develop a comprehensive and fair definition of such services for the purposes of legislation.

Recommendation: The proposed legislation and regulations should require the full and clear disclosure of commissions and all other types of compensation (except base salary) to be received by the financial planner if the consumer purchases any product recommended by the planner. This disclosure should take place prior to the purchase being completed.

When the planner may be compensated based on what is sold, and compensation may vary from one product to another, the consumer is entitled to know the planner's rate of compensation for each product.

Recommendation: The Committee recommends that appropriate government officials immediately develop a compensation disclosure scheme which would be implemented on a voluntary basis at the earliest possible moment. Officials should seek industry comment and assistance in developing the disclosure scheme. The Canadian Association of Financial Planners (CAFP) should be asked to adopt this scheme as a requirement for its members and should also ask all other financial planners to adopt the scheme by the same date.

While use of the scheme would be voluntary, its introduction should be advertised by the government and the CAFP in order to encourage consumers to request it. Consumers should not have to wait until regulation of financial planners is in place to learn of the personal motivations of financial planners arising from the compensation they receive for the products they sell.

6.3 Legislating Cooling-off Periods

Current Situation

Many people acquire large amounts of cash through various means. They often want to invest this cash in something other than a savings deposit. Many of these people do not have the level of investment expertise that the financial industry and government, through its legislation, often assume comes with the acquisition of such large amounts of money.

The Committee concluded these people could be divided into three groups:

1. **Consumers who have accumulated money in areas of employment outside the financial industry and who have little or no expertise in financial matters.**

2. **People nearing retirement who have money invested in products such as Registered Retirement Savings Plans and who are faced with making appropriate decisions regarding Registered Retirement Income Funds and annuities.**

3. **People who acquire money by such means as insurance claims and inheritance.**

Without Cooling-off Periods, These Investors Are at Risk

With a significant amount of money at stake, an inappropriate investment decision could have a significant detrimental effect on the future financial well-being of these types of people. Special consideration should be given to ensure they receive the proper information and the time to make an informed decision. The attractiveness of the large sums involved can leave these people open to particularly aggressive marketing strategies. They may be pressured to make a final decision before they have properly assessed their situation. Therefore, some form of buffer zone is required between the time these financial consumers make a decision and the time they make an irrevocable commitment.

Recommendation:

The Committee recommends further study of the possibility of the legislated cooling-off periods as part of the proposed *Consumer Savings and Investment Information Act*. The Committee notes that such a cooling-off period was established voluntarily by the life insurance industry for many contracts.

The Committee recognizes that cooling-off periods are not appropriate for some products in which the timing of the purchase is central to the pricing of the product. The Committee also recognizes that cooling-off periods cannot be allowed to be used as a means by which consumers play off one financial institution against another in order to achieve a more attractive rate of return.

6.4 Conflict of Interest and Self-dealing

Current Situation

There is an increased potential for abuse in the new financial marketplace. Changed relations between institutions give rise to new opportunities for self-dealing and conflict of interest.

Conflicts of Interest and Self-dealing Put Consumers at Risk

As the barriers to ownership of securities firms by financial institutions fall, so too does some of the independence of those firms which are acquired by persons or companies with other financial interests. As a result, the consumer may unknowingly accept advice from a securities firm which is not independent of the transaction because of its connection with others who have a financial interest in the transaction. To maintain a fair financial marketplace, dealing within and between financial organizations and personnel should be subject to better control.

Recommendations:

The chief recommendations of the Committee concerning potential self-dealing and conflict of interest arising from the ownership of securities firms by those with other financial or business interests are as follows:

- **Securities firms must disclose to their clients any relationship they have with a company whose securities are being offered for purchase or sale, or are the subject of their advice.**
- **Securities firms will be limited in some ways in the proportion of a new issue of securities they may handle where they have a relationship with the issuer which could influence their advice.**
- **Securities firms will be allowed to network with providers of financial products and services only on the condition that they disclose any material potential conflict of interest to the consumer.**

A detailed draft of the proposed legislation governing conflict of interest and self-dealing may be obtained by contacting the chairman of the Committee.

6.5 Preventing Insider Trading in Securities

Current Situation

Insider trading prohibitions do not extend to a large group of persons who may profit on the stock market from information acquired through *inside* sources not accessible to the public.

Insider Trading Puts Consumers at Risk

Penalties for insider trading are much smaller than the potential profits to be gained. The consumer may lose money or miss an opportunity for profit if those with access to inside information are able to profit before the public has received this information. Insider trading legislation should be amended to widen the group of persons who are considered insiders and to substantially increase penalties.

Recommendations:

The principal recommendations of the Committee concerning insider trading are:

- **expanding the *net* of those who are considered insiders to include persons who receive tips from insiders**
- **substantially increasing the penalties for insider trading.**

A detailed draft of the proposed legislation governing insider trading legislation and regulation can be obtained by contacting the chairman of the Committee.

6.6 Confidentiality of Consumer Information

Current Situation

In some cases, the industry has a practice of sharing information between departments of a given firm. Sometimes such information is sold from one organization to another.

Use of Confidential Information Puts Consumers at Risk

The consumer provides personal information in order to complete a transaction or use a service. This is often information which would not be freely given to another department of the same firm or to another seller of financial products and services. If the industry does not treat this information as strictly confidential, the consumer risks loss of privacy. The consumer's right to maintain the privacy of financial information must be preserved. Failure to legislate in this area will result in a continued potential for misuse of confidential information.

The consumer must have the opportunity to obtain all relevant information about any transaction. This includes knowing the ways in which the consumer's confidential information might be used by the financial institution and its personnel.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should require that all information received by a seller of financial products and services be kept strictly confidential and only be used for the purpose for which it was given.

An exception to this principle should only be made if specifically authorized in writing by the consumer in each and every case where it is proposed to use the information for any other purpose than that for which it was given.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should require that where a consumer authorizes the release of confidential information to another party, any compensation to be received for the release of the information be disclosed to the consumer before the written authorization is signed.

6.7 Industry Sponsored Insurance Funds

Parts of the Industry Have Insurance Funds in Place

For some time now, the securities industry has had the National Contingency Fund in place. This fund has given its governing body the discretionary option to make good on consumers' losses when industry firms are unable to do so. The fund has had limited assets in the past but is presently in the process of reviewing proposals to substantially increase assets. It is also proposed that coverage would shift from a discretionary to an obligatory basis.

The life insurance industry has proposed a fund to governments. Its structure and provisions are still being reviewed.

Recommendation: The Committee applauds the concept of industry funds to cover potential consumer losses. It recommends that a regular review be made of the provisions of such funds to ensure that:

- **all risks to the fund are analyzed**
- **the fund has in place sufficient assets to meet a reasonable estimate of the risks to which it might be exposed from time to time**
- **the nature of the legal relationship between the fund and the consumer is reasonable under the circumstances**
- **it is clear in disclosure information provided to the consumer what the provisions of the fund are, what legal claim the consumer has on the fund, and what process would be followed if such a claim became necessary.**

Extending the Industry's Financial *Safety Net* for Consumers

As noted elsewhere in the report, some parts of the retail financial industry have taken steps to introduce or strengthen programs to provide recompense to consumers. The Committee believes that a responsible industry will continue to do so.

Financial products and services are sometimes very difficult for consumers to assess. It is important for a fair and stable industry to provide financial resources which may be called upon in the event that one of its members is unable to repay what it owes to consumers. Industry funds should be a product of conscientious (delegated) regulation by industry.

Recommendation: The Committee recommends creating a situation in which each segment of the financial industry creates its own *safety net to* protect consumers in the event one of its members cannot meet its financial obligations. For example, if mutual fund agents are allowed to hold consumers' funds, they should be required to backstop the financial obligations to consumers of their fellow agents. This would create a situation similar to that which currently exists in the securities industry in relation to the National Contingency Fund.

6.8 Limiting *Networking* and *Cross-selling*

Current Situation

Terminology used in the new financial marketplace includes the term *networking*. While the term is relatively new, the activity it describes is not. Networking occurs whenever there is an arrangement whereby the products and/or services of one institution or individual are distributed to the consumer by another, whether related or not. Networking by related entities is also known as *cross-selling*. Networking involves, for example, sale of a financial product of a bank by its subsidiary securities firm.

To the financial industry:

"Be honest in business and in the information you provide."

Senior - Edmonton

Increasing complexity in the marketplace and increased cross-ownership of financial institutions leads to more opportunities to market one company's products through another, whether they are part of the same financial conglomerate or not. If the financial product or service does not require financial advice, this situation is not necessarily bad for consumers. However, in the current marketplace, the complexity of financial products often requires that the consumer rely on the financial advice of the seller. When such is the case, networking can put the consumer at risk. For example, a consumer might not know if the salesperson is providing unbiased advice or is being motivated by a higher commission from the sale of a *networked* product.

Undisclosed *Networking* and *Cross-selling* Put Consumers at Risk

Consumers often base their assessment of a financial product or service on the reputation of the seller. If consumers are not aware of who is actually providing a product or service, they may base their decisions on the financial health of an entirely different institution. This may expose consumers to unnecessary risk.

Normal standards respecting disclosure to consumers must apply to *networked* products. In particular, the consumer is entitled to know clearly whose product is being sold. It should be absolutely clear when seller and provider are different. Consumers are entitled to full disclosure respecting arrangements whereby products of one institution are sold by another institution.

Recommendation: The proposed *Consumer Savings and Investment Information Act* should require full and clear disclosure respecting any *cross-sold* or *networked* product. At a minimum, the following should be disclosed in a standard format used by the entire financial industry:

- **a full description of the relationship between the seller and the provider of the product**
- **a full description of any compensation received by the seller for selling the product**
- **a statement of the extent, if any, to which the seller of the product provides financial backing if the provider fails and also a statement of the extent to which such financial backing is not provided**
- **a statement that the seller and provider of the product are different parties.**

6.9 Limiting Term Note Disclosure Exemptions

Current Situation

Certain term notes not less than $50,000 in amount and not more than one year in duration may be sold without disclosure. The existing *Securities Act* exemption for these notes under **Section 66(d)** was intended to provide for trading of relatively secure commercial notes, generally among professional investors and institutions. However, this exemption has been used for raising funds from smaller investors, with no disclosure.

Term Note Exemptions Put Consumers at Risk

The consumer may be sold securities for which there is no disclosure. Failure to meet some disclosure standard exposes the consumer to the purchase of products whose risk is not readily ascertainable. The product may be riskier than the investor either wishes or realizes.

Recommendation: The Committee recommends introducing an amendment to the *Securities Act* requiring that term notes exempted under **Section 66(d)** of the *Securities Act* be issued only where the amount of the note is greater than $100,000.

6.10 Regulating Commodities Futures Dealers

Current Situation

There is no regulation of commodities futures dealers in Alberta.

Lack of Commodities Futures Regulation Puts Consumers at Risk

Currently, the consumer is dealing with a segment of the financial marketplace which is totally unregulated except for those commodities transactions conducted with a member of a securities industry self-regulatory organization. As a result, the consumer is unable to rely on standards of conduct, rules about the handling of funds, or any consistent disclosure about risks of the investment. A group which is not subject to regulation should not handle consumer funds and sell financial products and advice to consumers.

Recommendation:

The Committee recommends introducing legislation to regulate dealers in commodities futures in at least the following respects:

- **a consistent level of training, examination, and continuing education should be required of all personnel advising consumers about commodities futures purchases**
- **a prohibition should be created which prevents commodities dealers handling funds directly unless they are a member of an approved Delegated Regulatory Organization with adequate safeguards against loss of the consumer's funds**
- **a clear statement of risks, manner of doing business, and compensation received by the commodities broker should be provided to the consumer.**

6.11 Restrictions on Mortgage Banking

Current Situation

There are presently no legislative restrictions on who may assemble mortgage funds from a variety of investors and then look for mortgages in which to place them. The proper mortgage brokerage function involves only the matching of a particular lender and borrower.

Unrestricted Mortgage Banking Puts Consumers at Risk

The consumer may be asked to place funds in a pool to be invested in mortgages. This is essentially the same function as that which is undertaken by banks, trust companies, and credit unions. However, there is little or no government supervision of this handling of funds. In addition, the solvency controls which apply to normal deposit taking institutions do not apply to pooled mortgage funds. This is another case of acting like a bank without being regulated like one.

Recommendation: The Committee recommends that only those participants in the financial sector who are subject to solvency rules and government supervision as deposit-taking institutions should be permitted to accept public funds on a pooled liability basis. Mortgage banking by unregulated persons should be forbidden by legislation.

6.12 Restrictions on Investment Contracts

Current Situation

While not regulated in the same way as deposit-taking institutions such as banks, trust companies, and credit unions, investment contract companies accept what may readily appear to the public to be deposits.

Unrestricted Investment Contracts Put Consumers at Risk

In purchasing an investment contract, the consumer is investing in a security which looks much like a deposit, but which is very different. It is not insured. It is also on *deposit* with a financial institution which is not supervised like a bank, trust company or credit union. As a result, the consumer is purchasing a risk security without the normal protection of the *Securities Act.*

Recommendation:

Investment contracts should no longer be exempt from the prospectus requirements of the *Securities Act.* They should be sold only by personnel who are registered representatives under the *Securities Act.*

The time has passed when the consumer should have to determine whether the product they are obtaining is really a deposit, or just resembles one. Only through full disclosure will the consumer be aware of the terms of the contract.

6.13 Restricting Handling of Investment Funds

Current Situation

A variety of participants in the financial industry are permitted to hold consumer funds intended for investment purposes. There are capitalization and/or trust requirements on some of these persons; there are no requirements of any kind on others. Some participants in the financial industry (such as the securities dealers who belong to the National Contingency Fund) have arranged substantial backup for their individual financial obligations to the consumer while others have none.

Without Restrictions, Consumers Are at Risk

The consumer is placing funds with firms whose management skills and level of supervision by government do not provide adequate assurance that the funds will be kept whole. Most of these organizations cannot offer any financial backstop in the event of bankruptcy. For example, there is no insurance covering funds placed with mortgage brokers, mutual fund agents, and dealers (other than those who are also securities dealers and members of the Investment Dealers Association or a stock exchange), commodities brokers, chartered accountants, and others.

To the financial industry:

"Give accurate information, and demand honesty from all employees."

Consumer - Edmonton

The consumer should not be exposed to more than the minimum possible risk of loss of funds through potential mismanagement or dishonesty on the part of the person holding the money. It is illogical to place careful controls on a limited range of financial institutions and at the same time allow persons who are not regulated as heavily (or at all) to handle funds freely.

Recommendation:

The Committee recommends that persons who are not part of regulated financial institutions, or backed by an acceptable industry protection fund such as the National Contingency Fund (NCF), not be allowed to handle consumers' funds for investment purposes. This restriction would include any participants in the securities industry who are not members of the NCF.

This recommendation should not have any impact on those who handle funds as part of their normal business, such as lawyers who do so in the course of the practice of law and have their own protection arrangements as well as executors of wills and trust instruments who are not lawyers.

7.

The Dynamic Regulatory Model

7.1 Overview

Current Situation

The retail financial environment has changed substantially and permanently. Gone is the time when regulation could be accomplished by limited government supervision of a restricted range of product sellers. Gone too is the market in which those sellers offered a limited range of straightforward products.

We have entered an era where sellers of financial products have crossed most of the boundaries which previously separated them from one another. As a result, the personnel of various institutions are offering products with which they were not previously familiar. Increasingly, with these products comes advice about which product to buy, often in the guise of *personal financial planning*.

> To Consumer & Corporate Affairs:
>
> *" Emphasize to the public that they must take the final responsibility. Outline what government is doing to protect them, but that government can't protect them 100% without stifling free enterprise."*
>
> Retirement saver - Edmonton

Safeguards Against Abuse Are Inadequate

The complexity of the market has grown much faster than the safeguards against abuse. Therefore, there is a pressing need for government response to the situation.

Greater responsibilities for regulation arise from a more developed and more complex interrelationship of products. Regulation must be more sophisticated in order to cope with an environment which is dynamic and in which new products and services are developed constantly, with a seemingly unending variety of features.

The public is calling for stronger government control over the activities of financial industry personnel. Many consumers feel that current regulations do not adequately protect them in today's complex marketplace.

7.2 The Design of the System

> To Consumer & Corporate Affairs:
>
> *"Enforce the rules."*
>
> Investor - Calgary

The System Must Be Carefully Monitored

The regulatory system of the 1990's must be one in which government takes a strong role in ensuring that a dynamic financial environment is watched carefully. Government must ensure that new situations requiring regulatory attention do not escape the notice of those who are responsible for maintenance of standards in the system.

The Regulation of Financial Industry Personnel

The regulatory system must also focus intensively on the personnel in the system. The point of interaction between the consumer and the financial institution is increasingly at the level of the individual staff member who is giving advice.

No longer is most interaction with financial institution personnel of a clerical nature, involving deposits, cheque processing, and so on. Currently, many Albertans are faced with the need for advice as to which of many complicated financial products would best suit their needs. They turn for advice, consciously or otherwise, to financial industry personnel. Therefore, the focus of the new regulatory thrust must be on those personnel.

The Government Industry Partnership

The government has a major and necessary role to play in assuring suitable behaviour in personnel and the institutions they represent. The resources required to monitor the new financial services environment are so great that government will also have to call on industry to assist in performing the task. This will be accomplished through a delegated responsibility for some supervisory functions, where industry is qualified to accept such delegation. Government will continue to maintain close supervision over any industry Delegated Regulatory Organization (DRO) which accepts a role in monitoring the behaviour of its own members.

All Industry Segments Must Be Monitored

To Consumer & Corporate Affairs:

"Check industry operations frequently."

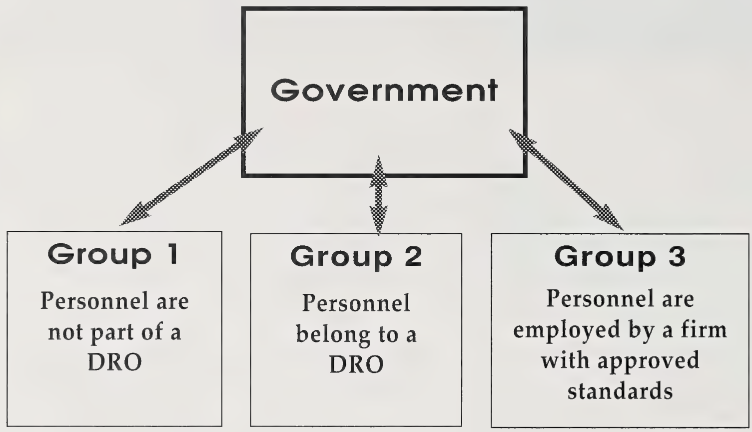
Retirement Saver - Manning

Central to the new regulatory regime will be its focus on personnel in all industry segments. No longer will it be possible to properly regulate one sector unless the impact of all its product offerings on its standards of practice is considered. Crossing of traditional product lines by industry must mean that regulation too crosses these boundaries. Personnel representing banks, trust companies, credit unions, life insurers, and many other traditional industry segments will all be required to meet the same set of standards.

7.3 The Regulatory Framework

Existing Regulation Versus Proposed Model

The existing regulatory framework looks like this:



Group 1 personnel are those who are not part of an industry organization which supervises their standards of practice. These individuals (and their firms) are regulated directly by government. Registration with a government agency and monitoring of standards of practice by government on a direct and regular basis is required.

An example of Group 1 personnel would be personnel of a securities firm which is neither a member of the Investment Dealers Association nor of a stock exchange.

Group 2 personnel are those whose industry has accepted the responsibility for supervising the standards of practice of their personnel (and firms). The industry monitors adherence to a set of standards, and disciplines those members who deviate from them. These firms would be required to report on the performance of their activities to some government agency. This agency would also have the responsibility to regularly review the activities of the Delegated Regulatory Organization and ensure that it is meeting all its obligations. Government would reserve the right to remove any or all powers from a DRO if they were not being exercised diligently.

Existing Regulation Versus Proposed Model continued

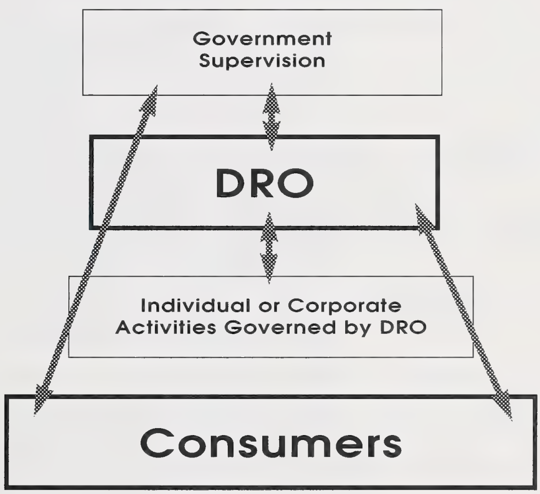
An example of Group 2 personnel would be stock brokers working for an Investment Dealers Association member, or financial planners belonging to a government-accredited DRO in the future.

> To Consumer & Corporate Affairs:
>
> *"Protect my financial investments, but do not overregulate to the point where the industry is fully controlled by government."*
>
> Investor - Edmonton

Group 3 personnel are those whose firms provide a portion of the supervision which would otherwise come from a DRO. The activities of the firm itself continue to be monitored by the government. The role of the firm in supervising the practice standards of its own staff allows the government to avoid bearing the burden of this work directly. However, the government continues to monitor closely the firm's performance of its supervisory role.

An example of Group 3 personnel might be financial planners whose firm's standards of training meet or exceed those generally required of all financial planners.

The Committee believes the regulatory model should look like this:



The Committee wants to see industry take as much responsibility as possible for its own regulation. The creation of a flexible and interactive relationship between government and DROs is crucial to this process.

7.4 Standards of Practice

Overview

It is important to note that in the recommended regulatory framework there should be regulation of the firms involved as well as individual employees.

The following are examples of the effect of the proposed framework:

Effect of Regulatory Framework on Financial Institutions

Where a financial institution wishes to have its personnel sell mutual funds, it is required to form a subsidiary to do so. The subsidiary is subject to the same degree of regulation as any other mutual fund agent. Its personnel are required to meet the same tests for registration as other mutual fund salespersons. In fact, the Alberta Securities Commission, in conjunction with the Canadian Securities Administrators, have adopted such a requirement in their recent policy statement entitled *Distribution of Mutual Funds by Financial Institutions.* Thus, regulation crosses institutional lines and is maintained on a basis of function. It would, however, be possible for individual industry segments to create their own training programs to meet the necessary training requirements. These programs would have to meet the same objectives and requirements of other mutual fund courses and would be subject to government approval.

Effect of Regulatory Framework on Life Insurance Agents

Life insurance agents sell several investment products which are similar to mutual funds and other products sold by other parts of the financial industry. They would be required to complete the same or an equivalent training program as other sales personnel. Their products would be subject to the same standard disclosure requirements as other similar products.

It is also important to note that a common set of standards meeting at least certain minimum criteria should be in place for all three groups.

Without Monitoring of Personnel, Consumers Are at Risk

Failure to work toward a regulatory regime where all industry personnel and their firms are subject to constant monitoring of their standards of practice increases the potential for losses to the consumer. The consumer may purchase an inappropriate product because of incorrect advice given by an industry financial advisor.

Recommendation: The government should review the activities of all financial industry personnel and place a high priority on initiating a plan to ensure that appropriate standards of practice are being met. Where existing structures are in place, such as the supervision of the investment industry by the Alberta Securities Commission, there should be a review to determine that all personnel being monitored by such an agency are meeting acceptable standards of practice.

Government Monitoring of Delegated Regulatory Organizations

The government should monitor the performance of their role by Delegated Regulatory Organizations (DROs) through:

- **reviewing and approving initial bylaws (where applicable) and any subsequent bylaw changes**
- **reviewing and approving educational requirements and programs**
- **reviewing and approving procedures to test compliance with requirements and standards of conduct**
- **reviewing on a detailed, regular, and consistent basis, industry's conduct of disciplinary cases**
- **a regularly publicized ability for a complainant to appeal any decision of the DRO's disciplinary body to the relevant government agency**
- **the ability for the disciplinary body to refer any case at any stage to the government agency for a hearing where the disciplinary body's powers are insufficient to allow it to obtain what it believes to be all the facts in the case (e.g. the power to subpoena a witness).**

The Transition to New Standards of Practice

A full review of the existing controls over industry and a consideration of how to move to a functional, cross-industry regulatory regime will take time. The government should establish a clear timetable for how it will move to a functioning regime such as that described in this section of the report. Priority must be given to establishing a common minimum set of standards for training and conduct, followed by the evolution of a mature system for regulation of all participants in the new financial marketplace.

To the financial industry:

"Have people with certificates, trained to serve."

Retirement investor - Hanna

The Committee is pleased to note a movement in the direction of common standards on the part of the Alberta Securities Commission, which has recently issued two regulatory policy statements. As was noted, one statement deals with mutual fund distribution by financial institutions. The other statement sets standards for the full-service and discount brokerage activities of securities dealers operating in the branch offices of financial institutions. These policies will require common treatment for all financial institutions participating in the securities market in Alberta.

In today's complex and dynamic retail financial market, consumers are relying every day on the advice of industry personnel in making their savings and investment decisions. Many personnel of financial institutions and independent financial professionals are no longer sellers of straightforward products. They have become providers of advice, who often also have a product to sell. As a result, they must be required to accept the responsibilities which come with offering financial advice and counselling to the consumer.

7.5 Educational Standards

Consumers Rely on Standards of Training

The complexity of financial products and services today means that individual institutions and their personnel cannot be left to their own devices for their educational preparation. Consumers must be able to rely on a common, acceptable standard of training when they deal with financial industry personnel.

A Minimum Standard Should Be Met

There should be minimum educational standards for all registrants. In order to acquire and maintain registration, a person dealing with the public should meet an approved combination of previous education and training for the specific task by an approved training body. Where differing levels of subject matter or complexity are involved in the products or services offered by different personnel to the public, different educational standards may be appropriate.

Advisors Must Have Up-to-Date Information

The rapid changes which characterize the retail financial market mean that personnel should be brought up-to-date regularly and frequently. A formal requirement for these people to meet industry-wide criteria will enable the consumer to know that information or advice being provided is based on current legislation, product offerings, market conditions, and other relevant information.

Continuing Education of Personnel Should Be Compulsory

There should be compulsory continuing education for all personnel who deal with the consumer. Failure to maintain a satisfactory record of continuing education should mean denial of the opportunity to deal with the public.

7.6 Standards of Behaviour

Professionalism Demands a Code of Conduct

It is clear that the provision of financial products and services is increasingly represented as a professional service by those who offer it. Accordingly, those who offer this service must have a common set of rules which govern the trust which they ask the public to place in them, as is the case with the traditional professions. Increased opportunities for profitable service to the consumer impose a responsibility on the financial industry and its personnel to govern their own conduct toward their customer in a correct manner.

Expectations and Penalties Should Be Clear

Financial industry personnel offering products and/or services to the public should follow a *Code of Conduct* appropriate to the products or services being offered. This *Code of Conduct* should spell out what is acceptable behaviour and what is not. The *Code of Conduct* should also make clear what penalties will result from failure to observe it.

It seems likely that government, in cooperation with industry, will need to develop a basic *Code of Conduct* applicable to all industry personnel. Individual Delegated Regulatory Organizations or firms may need to enhance the *Code of Conduct* in order to suit the circumstances of specialized product offerings.

A Disciplinary System Is All Important

Only if a healthy and rigorous disciplinary system exists will the government and any Delegated Regulatory Organizations properly perform their function of policing industry personnel. The disciplinary system should be beyond reproach in respect to its fairness and independence.

Disciplinary Action Should Be Swift, Sure, & Effective

There should be a disciplinary procedure which is inescapable, forceful, and structured in such a way that it is as immune as possible from pressure and influence. For example, Delegated Regulatory Organizations (DROs) should include a member of the public on the hearing panel each time a case is heard. When any DRO staff, such as enforcement officials or managers, involved in disciplinary matters resign or are terminated by the DRO as a result of a disciplinary proceeding, a full written explanation should be provided to the appropriate government agency.

Disciplinary Actions Should Be Enforceable

Whether operated by government, industry, or both, the disciplinary body should not be put in the position of finding fault and then being unable to enforce a meaningful sanction on the individual or institution involved. Certain violations may be so severe that automatic suspension or expulsion is required.

Sanctions Should Be Meaningful

Disciplinary sanctions, while being fair to the personnel involved, should be appropriate to the offense, and forceful enough to be meaningful in the particular circumstances.

7.7 The Regulatory Alert System

Current Situation

Regulators responsible for the activities of financial institutions are generally separated along vertical (institutional) lines.

Institutionally-directed Regulation Puts Consumers at Risk

Difficulties of a financial institution which may lead to losses for consumers are often not communicated promptly to other regulators. Needless risk to the consumer is created when one regulator continues to approve new ventures of a person or an institution while another regulator is deeply concerned about the behaviour or solvency of the same person or institution.

Consumers should not be put at risk by any failure on the part of the regulatory system to fully communicate consumer risks to all appropriate regulators within the system.

Recommendations:

The Committee recommends that the minister initiate with her fellow ministers in Alberta a system whereby regulators would be required to alert other regulators immediately in the event of any difficulty with a participant in the retail financial marketplace. This should include a cross-reference of all the products which the participant (or related parties) are selling in the market.

The Committee acknowledges that the western provinces have reached an accord on the sharing of certain information useful to financial regulators. It applauds this development and urges government to pursue further development of such accords.

Recommendation:

All Delegated Regulatory Organizations should, as a condition of their ability to operate, be required to notify the responsible government regulator immediately upon becoming aware of any risk to consumers arising from the behaviour or solvency of any of their member personnel or institutions.

If the delegated regulatory portion of the regulatory model is to provide safeguards to consumers, it must immediately communicate all consumer risks to the government regulator who has the power to minimize consumer risk.

7.8 Removing Financial Institution Exemptions

Current Situation

There are presently exemptions in the *Securities Act* which permit a financial institution (bank, trust company, treasury branch, or credit union) to sell securities to its customers if the order from the customer is not solicited by the institution.

Trust companies are permitted by an exemption in the *Act* to sell their own mutual funds. In addition, there exist orders granted by the Alberta Securities Commission which permit certain banks to sell their own mutual funds.

Exemptions Create Different Rules for Different Sellers

The consumer is purchasing securities and mutual funds from persons who do not necessarily meet consistent standards of training, experience, conduct, and discipline. Advice may be sought by the consumer and provided by the institution which is not based on the same standards as it would be if received from another source in the financial industry.

The consumer should be able to rely on a consistent set of standards for personnel selling equivalent or similar products. Rules for disclosure respecting both product and sales personnel should be same where the product is the same or similar.

The consumer will find it increasingly difficult to distinguish between the role of the financial institution as an accepter of deposits and the role of the financial institution as a provider of financial advice. As a result, there is increasing risk that the consumer will find it difficult to differentiate between impartial advice regarding financial position, and advice to buy or sell a particular product when both kinds of advice may be offered by the same person or institution.

In view of the substantially greater resources at the disposal of the financial industry, the consumer should not have to guess at, or investigate unaided, the potential differences between similar products sold by different financial institutions or intermediaries. These differences should be clearly explained by personnel who meet common standards of training and behaviour and whose motivation is clear to the consumer.

Recommendations:

The Committee recommends an amendment to the *Securities Act* to remove the exemption under **Section 65(1)(k)** of the *Act* which permits financial institutions to accept orders for securities when such orders are unsolicited.

The Committee recommends an amendment to the *Securities Act* to remove the exemption under **Section 65(1)(y.2)** for the sale by a trust company, through its own offices, of mutual funds promoted, managed, and administered by the company.

The Committee recommends an amendment to the *Securities Act* to remove the exemption under **Section 66(c)** allowing the sale of certain pooled funds maintained to serve Registered Retirement Savings Plans and other plans (generally income tax-oriented) as described in **Section 1(q)(ii)(A)** of the *Act*.

Financial institutions and their personnel should be permitted to conduct these activities only through a duly registered subsidiary. The personnel of financial institutions and their subsidiaries should be subject to the same rules as other sellers of financial products and services.

The Committee notes that the Alberta Securities Commission has begun to move in the direction of restricting or eliminating these exemptions in their recent policy on participation of financial institutions in the securities market.

8.

Financial Industry's Role in the Marketplace

8.1 Overview

Industry Can Provide Leadership

The retail financial industry has the expertise, experience, and resources to provide leadership in meeting the challenges of maintaining a fair marketplace into the 1990's and beyond. In addition, the industry has access to consumer attitude studies and other resource materials not generally available to regulators or consumers.

Industry Has a Responsibility to Consumers

The industry has provided leadership in product development, to the considerable benefit of many consumers. In some cases, it has also taken steps in consumer education and in regulating the activities of its own members. Given the concerns outlined in this report, the time has come for industry to play a more concerted role in ensuring a fair marketplace for consumers.

Recommendations:

The Committee recommends that the minister call upon all segments of the retail financial industry in Alberta to cooperate in providing leadership in development in three major areas:

- **maintaining consumer safeguards**
- **ongoing consumer education**
- **accepting responsibility for the standards of competence and behaviour in the marketplace.**

8.2 Ongoing Consumer Education

Current Situation

In a random survey of industry publications, the Committee did not find a readily accessible clearinghouse of comparative consumer information. The Committee did note some excellent work done by some industry groups, such as the Canadian Bankers' Association. However, there do not appear to be common standards of quality and objectivity in the material produced by various industry groups and individual firms. The Committee noted some opportunities for classroom or self-study for consumers. Once again, there appears to be neither a common set of standards for such education nor a central point of access to it.

Without Ongoing Education, Consumers Are at Risk

The financial industry has the resources to allow it to provide information of its own choosing to the consumer. The consumer can experience great difficulty sorting out all this information in order to make reasoned choices. Due to lack of information about how to compare different products, the consumer may make inappropriate choices because of inadequate information.

The financial industry should shoulder a greater and more consistent responsibility among all its members for consumer education. The industry has the knowledge and skills at its disposal to contribute to the creation of a viable series of educational opportunities for the consumer.

Recommendations:

The Committee recommends establishing a joint industry and government educational task force to set goals for consumer education for the coming year and for a three-year and five-year time frame. The recommended activities of this Task Force are outlined on page 45 of this report.

8.3 Standards of Practice

Current Situation

At present, no common set of standards exists which would give the consumer at least a minimum degree of comfort about the qualifications and conduct of industry personnel. Even in individual industry segments, the setting of standards for personnel is of varying quality and completeness. Some segments of the industry have no agreed standards at all.

A Lack of Standards Puts Consumers at Risk

Products and services are increasingly complex. Industry personnel are more and more involved in providing financial advice and often hold themselves out as professional advisors. The consumer may accept advice from industry personnel who are not properly qualified and whose conduct is not monitored.

Recommendation:

Whether regulation is done by government, a Delegated Regulatory Organization, or limited delegation of regulation to an individual firm, the standards of practice to be observed by industry personnel and firms must include the following components:

- **education**
- **specific training for products/services being sold**
- **supervision by experienced personnel**
- **standard of conduct**
- **disciplinary procedures.**

The role of government is to ensure that each component part of the standards is in place and that it is consistent for comparable industry personnel. The government's role is also to monitor performance of delegated responsibility for enforcement of standards through regular performance audits.

Recommendations:

Financial advice and counselling should not be given unless one is registered with a government agency or a Delegated Regulatory Organization.

All those dealing with the consumer in the financial industry, in any position which involves the provision of any type of financial advice, should follow the same set of rules respecting consumer safeguards. Doing so would ensure the consumer could expect and receive consistent treatment. In addition, the ultimate penalty for any personnel who are required to be registered should be suspension or cancellation of registration. If a firm or individual ir the industry were able to carry on business despite its status as a non-registrant, the crucial task of supervision of standards could not be accomplished.

9.

Government's Role in the Marketplace

9.1 Overview

Scope of Activities

The Committee believes the government has an ongoing role to play in the financial marketplace. Consumers will not be well served if this role is strictly limited to legislation and regulation. Government must be an active participant in the financial marketplace. As indicated in this report, maintaining a fair financial marketplace will require an interactive partnership among industry, consumers, and government. Achieving this interactive partnership will require constant communication and cooperation among each of the members. Three key roles for government to play are outlined here.

To Consumer & Corporate Affairs:

"The government could provide some financial information to the consumer."

Consumer - Manning

Educational Role

Government has a major role to play in the ongoing education of consumers. Consumers cannot make informed financial decisions without a clear understanding of the products and services which are being offered in the financial marketplace. Because the marketplace is changing rapidly, it is difficult for the individual consumer to develop this knowledge without assistance.

Regulatory Role

The complexity and scope of the current financial marketplace requires the establishment of Delegated Regulatory Organizations. It is unreasonable and impractical for government to try to actively regulate every segment of the marketplace. However, the government is obligated to closely monitor Delegated Regulatory Organizations. Any deviations from approved practices must be dealt with quickly and effectively. Consumer confidence in the financial marketplace directly depends on this being the case.

Communication and Cooperation with Industry

Government will not be able to play its role in the interactive partnership discussed in this report without a stated intent to communicate and cooperate with industry. This communication and cooperation must take place on a formal and informal basis.

9.2 Ongoing Consumer Education

Current Situation

The Committee found that activities in consumer information, while they do exist, are inadequate to meet the enormous challenge presented by today's fast-changing financial market.

Without Ongoing Education, Consumers Are at Risk

If consumers do not have enough information to allow them to know if they are making informed decisions, they may make needlessly risky ones. They may buy products which do not suit their personal financial objectives. And they may act on advice from untrained personnel. While the provision of full and clear information will assist in the long run, the consumer needs immediate help in sorting out existing financial opportunities.

Recommendation: The Committee recommends undertaking a comprehensive information campaign to raise consumer awareness of the issues to be considered in making a deposit or an investment. The Committee believes that the campaign should consist of periodic reinforcement of the initial information.

Recommendation: The Committee recommends establishing within the Department of Consumer and Corporate Affairs a financial education task force to ensure prompt development of suitable educational materials as part of the recommended government/industry task force discussed on page 45 of this report.

The Committee recommends requesting the participation of other government departments in assisting this task force. The preparation of consumer education materials will require the experience and objectivity which the government can bring to the discussions.

Recommendation: The Committee recommends using the existing Alberta continuing education network for presentation of consumer courses. The government has in place a network for the extension of various educational opportunities to all Alberta communities. It would be most efficient to use this network as a key focus for dissemination of consumer educational information.

Recommendation: The Committee recommends calling for proposals from educational institutions and the private sector for the provision of consumer education courses on an ongoing basis.

Because of the changing market, there will be an ongoing need for consumer education. Those institutions and private concerns already in the educational field provide an excellent resource for dissemination of unbiased, up-to-date consumer education information.

10.

Conclusion

10.1 The Continuing Challenge

Industry & Government Want to Maintain a Fair Marketplace

Throughout its activities, the *Committee on Fair Dealing in Consumer Savings and Investments* was impressed by the wealth of knowledge possessed by both the financial industry and government. Both industry and government seem to be genuinely interested in working toward a fair financial marketplace, one which reflects the changes which have taken place in technology and the way in which products and services are sold.

To Consumer & Corporate Affairs:

"Have a reliable source of industry information. Weigh results carefully and only regulate where necessary."

Consumer - Edmonton

As this report indicates, some parts of the industry are leading the way in adapting standards for information and personnel to meet the public's current expectations. Unfortunately, other parts of the industry are tending to resist change until it is forced upon them. The Committee strongly believes that continued communication and cooperation between industry and government is essential. The Committee is pleased that this spirit of cooperation characterized most of its own meetings and discussions with industry.

The Need for a Forum for Discussion

The required communication and cooperation between industry and government outlined in this report will not occur unless there is a forum for them. Accordingly, the Committee suggests that the minister convene a conference in the near future to review how ongoing industry/government communication and cooperation can best be achieved.

One idea which might be considered is a *Financial Standards Council* which would consider standards of training, experience, and behaviour for all industry personnel. Such a body would clearly need direct contact with the individual industry associations. It is these associations who would be best qualified to comment on how such standards would affect their own firms and individual personnel.

To the financial industry:

"Send people out to functions and schools to tell kids how to invest."

Teenager - Edmonton

Reaching the Consumer Is Difficult But Essential

The Committee realizes that reaching the consumer is not always an easy task. However, the proposed conference should be charged with developing a workable mechanism for obtaining consumer input into standards being considered by a standards council or similar body.

Adequate consumer representation is essential if the dynamic partnership between industry, government, and consumers outlined in this report is to be achieved. A special effort must be made to ascertain consumers' views on how standards should be set. This effort must include both learning about new consumer issues and commenting on proposed approaches to them.

Creating and Supporting the Dynamic Partnership

The recommendations set forth in this report will, if implemented, go a long way in ensuring a fair, well-regulated financial marketplace. The Committee recognizes that it has set a number of time-consuming and arduous tasks for both industry and government. However, regardless of how onerous they might be, these tasks are only the first few steps in responding to what is and what can easily be foreseen. The real challenge will be to respond effectively to future developments which cannot be predicted.

As this report clearly indicates, the financial marketplace has entered a phase of rapid and constant change. The twin impacts of technology and reregulation will accelerate and magnify that change. No amount of regulation can fully control a future which cannot be predicted. This challenge can only be met through the ongoing cooperation and communication of the three members of the dynamic partnership.

If industry, government, and consumers recognize and accept the challenge of communication and cooperation, together they can ensure a fair financial marketplace well into the 1990's and beyond.

Appendices

Appendix 1 The Ministerial Advisory Committee on Fair Dealing in Consumer Savings and Investments

Chairman

J. Patrick Cashion, C.A. - J.P. Cashion & Associates Inc.
Member, Alberta Securities Commission

List of Members

Bob Ascah - Alberta Treasury

David Axler - Alberta Attorney General

Elaine Barnes - Family Economist

Robert Bhatia - Alberta Treasury

John Burns - Macleod Dixon

Meredith Degroat - Levesque Beaubien

Dallas Droppo - Fenerty Robertson

David Emerson - Canadian Western Bank

Gil Gibb - Walwyn Stodgell
Alberta Chairman, Investment Dealers' Association of Canada

Sally Hall - Past President, Consumers' Association of Canada

Gail Harding - Alberta Stock Exchange

Richard Larson - Alberta Legislative Counsel

Terry Melling - Investment Dealers' Association of Canada

Brian Miller - Alberta Consumer and Corporate Affairs

Joanne Miller - Alberta Economic Development and Trade

Bernie Rodrigues - Alberta Consumer and Corporate Affairs

Jack Rogers - Burns Fry Ltd.

Ken Shields - Alberta Consumer and Corporate Affairs

Peter Varsanyi - Code Hunter

Bill Veres - Transalta Utilities Corporation

Bill Welton - Nesbitt Thomson
Chairman, Alberta Stock Exchange

Accounting Principles

Generally Accepted Accounting Principles (GAAP) are the accounting concepts, measurement techniques, and standards of presentation used in the preparation of financial statements. Examples include the cost principle, the going concern assumption, and the objectivity principle.

Annuity

An annuity is an agreement by which money is deposited with an institution in return for regular payments over a specified future period.

Arbitration

Arbitration is a dispute-resolution process. Parties in disagreement submit their cases to a third party (arbitrator) whose decision is usually binding on the parties who are in disagreement.

Asset

An asset is anything of monetary value that is owned. A car and a house are examples of physical assets. A savings account, cash, and a bond are examples of financial assets.

Audit

An audit is an examination of accounting records by an independent accounting firm. The purpose of an audit is to enable the auditor to report on whether financial statements are prepared in accordance with Generally Accepted Accounting Principles.

Bank Act

The *Bank Act* is a federal law which regulates the operation of banks. This includes raising funds, primarily by accepting deposits such as savings, and re-lending them through loans to customers.

Canada Deposit Insurance Corporation (CDIC)

The Canada Deposit Insurance Corporation is a federal government crown corporation. The CDIC provides insurance, subject to certain limitations, against loss on certain financial products for all consumers who have deposits with member institutions. Member institutions include all banks and major trust companies which accept deposits from the public.

Canadian Association of Financial Planners (CAFP)

The Canadian Association of Financial Planners is a Canada-wide voluntary association of some 1,100 personal financial planners. It has created entrance requirements, a code of ethics, and standards for its members to follow.

Code of Conduct

A Code of Conduct is a set of rules established by a profession or other organization. It sets minimum standards of behaviour which members must follow in carrying out their duties.

Commodities Futures

Commodities Futures are contracts to buy or sell defined quantities of commodities such as grains, precious metals, oil, and lumber at specified future dates.

Compensation

Compensation is payment by one person or company to another for goods or services. In the financial industry, payment would be to a salesperson or company who sells a financial product or service. It can include a direct monetary payment in the form of salary or commission. It can also include an indirect method of payment such as reimbursement for the cost of office space or prizes for high volume sales.

Conflict of Interest

Conflict of Interest is any conflict which exists or might exist among the responsibilities of a person or company. For example, a financial advisor might give advice about an investment in which he or she has a financial interest.

Consumer Savings and Investment Information Act

The *Consumers Savings and Investment Information Act* is proposed legislation recommended by the Committee on Fair Dealing. This *Act* would provide general standards to the financial industry in their dealings with consumers. These standards would govern the nature and quality of information all vendors of financial products and services operating in Alberta must make available to the consumer.

Consumer and Corporate Affairs (Alberta)

Consumer and Corporate Affairs is the government department responsible for the development and implementation of policies, programs, services, and administrative procedures for consumer protection. Its mandate also includes licensing and registration requirements for entities such as provincially registered insurance companies and agents, mortgage brokers, real estate agents, and securities dealers.

Consumers' Association of Canada (CAC)

The Consumers' Association of Canada is a non-profit, national organization which obtains and provides information and counsel to consumers on matters relating to goods and services. The CAC also makes representations to government, trade, and industry on behalf of consumers, studies consumer problems, recommends action, and conducts research and tests.

Cooling-Off Period

A Cooling-Off Period is a time period set by law during which a consumer can withdraw from certain types of transactions.

Cross-selling - (see Networking)

Delegated Regulatory Organization (DRO)

A Delegated Regulatory Organization is an industry-run organization to which the government has delegated some or all of the regulation of its own members. This delegation can be revoked if the regulation does not live up to government's standards.

Deposit

A Deposit is money placed into an account provided by a financial institution. Interest is normally credited on the money at a specified rate and paid at specified dates.

Disclosure

Disclosure is the provision, by financial institutions and salespeople, of all information, positive or negative, that might influence a consumer's investment decision.

Financial Advisor

A Financial Advisor is anyone who, in return for any form of compensation, provides a recommendation about an individual's financial affairs.

Financial Planner

A Financial Planner is any person who holds himself out as a personal financial planner and who provides advice on any or all aspects of an individual's finances. This could include any or all of the following activities:

- identifying financial goals and objectives
- identifying financial problems and opportunities
- providing recommendations and alternative courses of action
- implementing recommendations, e.g., purchase of an investment product
- periodically reviewing and updating financial plans.

Four Pillars

The *"Four Pillars"* represent the four district traditional sectors of the financial industry: trust companies, banks, insurance companies, and securities dealers. The phrase *"dismantling of the four pillars"* refers to the gradual elimination of regulatory barriers which separated these traditional four sectors. This *"dismantling"* results in a general mixing or overlap of financial functions and activities provided by each sector.

Guarantee

A Guarantee is a promise that an institution will repay money deposited. The guarantee is of value only if the issuer is able to pay.

Guaranteed Investment Certificate (GIC)

A Guaranteed Investment Certificate guarantees a specified rate of interest for a stated period of time, normally one to five years. Usually it cannot be cashed before maturity.

Horizontal Regulation

Horizontal Regulation is government regulation of the financial industry by legislation which extends across the traditional institutional lines of the four financial sectors described under *"The Four Pillars"*. The proposed *Consumer Savings and Investment Information Act* would be an example of horizontal regulation since it would apply to personnel retailing financial products or services in any of the four traditional financial sectors. This is in contrast to the *Trust Companies Act* which is an example of vertical regulation since it applies to only one financial sector - trust companies.

Insider Trading

Insider Trading is the buying or selling of securities by a person, such as the senior officer of a company, who may be in a position to know about a company's plans or its financial position before that information is available to public investors.

Investment

An Investment is a financial asset owned for the purpose of earning a return. In this report, it is distinguished from a deposit. Examples are common stocks and mutual funds.

Investment Contract

An Investment Contract is a contract by which the issuer agrees to pay the investor a stated amount on a fixed date. The investor may have the option of demanding payment before or after maturity. This payment will be made according to a plan stated in the contract.

Investment Dealers Association (IDA)

The Investment Dealers Association is an association of Canadian investment dealers formed to enforce and maintain ethical and financial standards among its members.

Liquidity

Liquidity is the ease with which an investment can be converted into cash.

Material Information

Material Information is information that would, by its nature, be significant enough to affect the decision of a consumer regarding the purchase or sale of a financial product or service.

Mediation

Mediation is a dispute-resolution process where parties in disagreement bring their cases before a third party (mediator). If the third party has the power to impose its decision, the process is called arbitration. If a solution is only recommended, it is called conciliation.

Mortgage Banking

Mortgage Banking means an activity carried out by a company or individual consisting of lending mortgage funds and raising these funds from a variety of investors. The investor has no claim on any specific mortgage.

Mortgage Brokers Regulation Act

The *Mortgage Brokers Regulation Act* is an Alberta law which regulates the activities of all persons who, for a fee, solicit borrowers or lenders, negotiate, buy, sell, or exchange mortgages.

Mutual Fund

A Mutual Fund is money pooled by individuals for investment on their behalf, usually in a specific kind of investment such as common shares, mortgages, or real estate.

National Contingency Fund (NCF)

The National Contingency Fund is a trust fund established to protect individual investors in the event of the insolvency of any Member firm of the Investment Dealers Association of Canada, The Alberta, Montreal, Toronto, or Vancouver Stock Exchange.

Networking

Networking is an arrangement whereby products and/or services of one institution or individual are distributed to the consumer by another institution or individual.

Rating Service

A Rating Service is an independent organization. It provides objective risk ratings of financial products and financial institutions.

Registered Retirement Income Fund (RRIF)

A Registered Retirement Income Fund is established, usually at retirement, to provide payments to an individual during his or her retirement years. The assets in the RRIF are acquired by transfer from his or her RRSP.

Registered Retirement Savings Plan (RRSP)

A Registered Retirement Savings Plan is an individual retirement savings plan set up according to rules established by the federal government. This plan permits tax-deferred savings for retirement purposes.

Regulatory Framework (or Model)

Regulatory Framework is the structure of regulation of the financial industry by government. For example, all activities of trust companies are regulated by the *Trust Companies Act* (see Vertical Regulation). The Committee believes that this regulatory framework should be complemented by regulation by function.

Regulatory Alert

Regulatory Alert is a system by which regulators share information about the financial difficulties of a financial institution or intermediary, with the objective of consumer protection.

Risk

Risk is the degree of possibility that the consumer will lose any or all of an investment.

Safeguard

A Safeguard is a means of protecting the consumer against an unnecessary risk. For example, a cooling-off period would allow the consumer time to reverse certain investment transactions if, on reflection, the investment seems inappropriate.

Securities Act

The *Securities Act* is a provincial law which governs the conditions under which securities may be issued to the public. It generally regulates the activities of the securities industry.

Security

A Security is a document that signifies ownership of an investment asset such as shares, bonds, and debentures.

Self-dealing – (see Conflict of Interest)

Standards of Practice

Standards of Practice are rules setting a common minimum quality of performance. These rules address, for example, education, conduct, and discipline.

Term Deposit

A Term Deposit is a security issued by a financial institution such as a credit union, bank, or trust company that earns interest at a fixed rate for a specified period of time.

Timely Financial Information

Timely Financial Information means the provision of relevant financial information to the consumer at a time when it is useful in making an investment decision.

Treasury Bill/T-Bill

A Treasury Bill (also called a 'T-Bill') is a short-term interest-bearing note issued by a government.

Vertical Regulation

"Vertical Regulation" is a description of government regulation confined to the traditional institutional lines as described in the *"Four Pillars"*. For example, the *Trust Companies Act* only regulates the activities of one type of financial institution. The recommended common standards in the proposed *Savings and Investment Information Act* would apply to saving and investment products, regardless of who sells them.

Yield

Yield is the income from an investment expressed as a percentage of the investment's current market value or its original purchase price.